Oasis Petroleum Inc.
Form 10-Q
November 08, 2012
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UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-Q

x **QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**

For the quarterly period ended September 30, 2012

or

¨ **TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**

For the transition period from to

Commission file number: 1-34776

Oasis Petroleum Inc.

(Exact name of registrant as specified in its charter)

Delaware	**80-0554627**
(State or other jurisdiction of incorporation or organization)	**(I.R.S. Employer Identification No.)**
1001 Fannin Street, Suite 1500 Houston, Texas	**77002**
(Address of principal executive offices)	**(Zip Code)**

(281) 404-9500

(Registrant s telephone number, including area code)

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes x No ¨

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes x No ¨

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company. See the definitions of large accelerated filer, accelerated filer and smaller reporting company in Rule 12b-2 of the Exchange Act.

Large accelerated filer x	Accelerated filer ¨
Non-accelerated filer ¨ (Do not check if a smaller reporting company)	Smaller reporting company ¨

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act). Yes ¨ No x

Number of shares of the registrant s common stock outstanding at November 5, 2012: 93,366,522 shares.

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OASIS PETROLEUM INC.

FORM 10-Q

FOR THE QUARTER ENDED SEPTEMBER 30, 2012

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PART I FINANCIAL INFORMATION

Item 1. Financial Statements (Unaudited)

Oasis Petroleum Inc.

Condensed Consolidated Balance Sheet

(Unaudited)

	September 30, 2012	December 31, 2011
	(In thousands, except share data)	
ASSETS		
Current assets		
Cash and cash equivalents	$ 280,303	$ 470,872
Short-term investments	126,213	19,994
Accounts receivable oil and gas revenues	104,965	52,164
Accounts receivable joint interest partners	83,630	67,268
Inventory	21,142	3,543
Prepaid expenses	4,030	2,140
Advances to joint interest partners	4,025	3,935
Derivative instruments	17,320	
Deferred income taxes		3,233
Other current assets	78	491
Total current assets	641,706	623,640
Property, plant and equipment		
Oil and gas properties (successful efforts method)	2,079,016	1,235,357
Other property and equipment	45,261	20,859
Less: accumulated depreciation, depletion, amortization and impairment	(320,478)	(176,261)
Total property, plant and equipment, net	1,803,799	1,079,955
Derivative instruments	10,047	4,362
Deferred costs and other assets	25,349	19,425
Total assets	$ 2,480,901	$ 1,727,382
LIABILITIES AND STOCKHOLDERS EQUITY		
Current liabilities		
Accounts payable	$ 30,954	$ 12,207
Advances from joint interest partners	26,572	9,064
Revenues and production taxes payable	64,091	19,468
Accrued liabilities	200,544	119,692
Accrued interest payable	22,481	15,774
Derivative instruments	1,273	5,907
Deferred income taxes	3,782	
Other current liabilities	5,256	472
Total current liabilities	354,953	182,584
Long-term debt	1,200,000	800,000

Asset retirement obligations	20,529	13,075
Derivative instruments	360	3,505
Deferred income taxes	152,617	92,983
Other liabilities	2,078	997
Total liabilities	1,730,537	1,093,144
Commitments and contingencies (Note 12)		
Stockholders equity		
Common stock, $0.01 par value; 300,000,000 shares authorized; 93,435,593 issued and 93,369,468 outstanding at September 30, 2012; 92,483,393 issued and 92,460,914 outstanding at December 31, 2011	923	921
Treasury stock, at cost; 66,125 and 22,479 shares at September 30, 2012 and December 31, 2011, respectively	(1,901)	(602)
Additional paid-in-capital	653,999	647,374
Retained earnings (deficit)	97,343	(13,455)
Total stockholders equity	750,364	634,238
Total liabilities and stockholders equity	$ 2,480,901	$ 1,727,382

The accompanying notes are an integral part of these condensed consolidated financial statements.

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Oasis Petroleum Inc.

Condensed Consolidated Statement of Operations

(Unaudited)

	Three Months Ended September 30, 2012	Three Months Ended September 30, 2011	Nine Months Ended September 30, 2012	Nine Months Ended September 30, 2011
	(In thousands, except per share data)			
Revenues				
Oil and gas revenues	$ 178,748	$ 87,596	$ 461,857	$ 213,546
Well services revenues	5,963		10,484	
Total revenues	184,711	87,596	472,341	213,546
Expenses				
Lease operating expenses	16,134	9,597	37,979	21,178
Well services operating expenses	5,420		7,104	
Marketing, transportation and gathering expenses	2,744	238	7,283	797
Production taxes	16,433	8,873	43,419	22,041
Depreciation, depletion and amortization	57,684	20,859	140,783	47,771
Exploration expenses	336	54	3,171	345
Impairment of oil and gas properties	36	396	2,607	3,313
General and administrative expenses	13,886	7,306	39,622	19,870
Total expenses	112,673	47,323	281,968	115,315
Operating income	72,038	40,273	190,373	98,231
Other income (expense)				
Net gain (loss) on derivative instruments	(22,441)	71,224	33,568	67,105
Interest expense	(20,979)	(6,786)	(48,952)	(18,745)
Other income	1,147	524	2,521	1,215
Total other income (expense)	(42,273)	64,962	(12,863)	49,575
Income before income taxes	29,765	105,235	177,510	147,806
Income tax expense	11,451	38,946	66,712	55,015
Net income	$ 18,314	$ 66,289	$ 110,798	$ 92,791
Earnings per share:				
Basic and diluted (Note 11)	$ 0.20	$ 0.72	$ 1.20	$ 1.01
Weighted average shares outstanding:				
Basic (Note 11)	92,186	92,060	92,164	92,052
Diluted (Note 11)	92,416	92,164	92,343	92,208

The accompanying notes are an integral part of these condensed consolidated financial statements.

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Oasis Petroleum Inc.

Condensed Consolidated Statement of Changes in Stockholders Equity

(Unaudited)

(In thousands)

	Common Stock		Treasury Stock		Additional	Retained Earnings	Total Stockholders
	Shares	Amount	Shares	Amount	Paid-in-Capital	(Deficit)	Equity
Balance as of December 31, 2011	92,461	$ 921	22	$ (602)	$ 647,374	$ (13,455)	$ 634,238
Stock-based compensation	952				6,627		6,627
Vesting of restricted shares		2			(2)		
Treasury stock tax withholdings	(44)		44	(1,299)			(1,299)
Net income						110,798	110,798
Balance as of September 30, 2012	93,369	$ 923	66	$ (1,901)	$ 653,999	$ 97,343	$ 750,364

The accompanying notes are an integral part of these condensed consolidated financial statements.

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Oasis Petroleum Inc.

Condensed Consolidated Statement of Cash Flows

(Unaudited)

	Nine Months Ended September 30, 2012	Nine Months Ended September 30, 2011
	(In thousands)	
Cash flows from operating activities:		
Net income	$ 110,798	$ 92,791
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation, depletion and amortization	140,783	47,771
Impairment of oil and gas properties	2,607	3,313
Deferred income taxes	66,648	55,015
Derivative instruments	(33,568)	(67,105)
Stock-based compensation expenses	6,627	2,592
Debt discount amortization and other	2,038	1,041
Working capital and other changes:		
Change in accounts receivable	(69,163)	(41,286)
Change in inventory	(26,790)	(1,850)
Change in prepaid expenses	(2,009)	(297)
Change in other current assets	413	(337)
Change in other assets	(119)	(103)
Change in accounts payable and accrued liabilities	79,079	47,820
Change in other current liabilities	4,784	
Change in other liabilities		317
Net cash provided by operating activities	282,128	139,682
Cash flows from investing activities:		
Capital expenditures	(777,426)	(386,927)
Derivative settlements	2,784	(4,831)
Purchases of short-term investments	(126,213)	(164,913)
Redemptions of short-term investments	19,994	39,974
Advances to joint interest partners	(90)	(408)
Advances from joint interest partners	17,508	8,093
Net cash used in investing activities	(863,443)	(509,012)
Cash flows from financing activities:		
Proceeds from issuance of senior notes	400,000	400,000
Purchases of treasury stock	(1,299)	(562)
Debt issuance costs	(7,955)	(10,027)
Net cash provided by financing activities	390,746	389,411
Increase (decrease) in cash and cash equivalents	(190,569)	20,081
Cash and cash equivalents:		
Beginning of period	470,872	143,520
End of period	$ 280,303	$ 163,601
Supplemental non-cash transactions:		

Change in accrued capital expenditures	$	71,572	$	23,422
Change in asset retirement obligations		7,774		3,925

The accompanying notes are an integral part of these condensed consolidated financial statements.

OASIS PETROLEUM INC.

Notes to Condensed Consolidated Financial Statements (Unaudited)

1. Organization and Operations of the Company

Organization

Oasis Petroleum Inc. (Oasis or the Company) was formed on February 25, 2010, pursuant to the laws of the State of Delaware, to become a holding company for Oasis Petroleum LLC (OP LLC), the Company s predecessor, which was formed as a Delaware limited liability company on February 26, 2007. In connection with its initial public offering in June 2010 and related corporate reorganization, the Company acquired all of the outstanding membership interests in OP LLC in exchange for shares of the Company s common stock. In May 2007, the Company formed Oasis Petroleum North America LLC (OPNA), a Delaware limited liability company, to conduct its domestic oil and natural gas exploration and production activities. In April 2008, the Company formed Oasis Petroleum International LLC (OPI), a Delaware limited liability company, to conduct business development activities outside of the United States of America. As of September 30, 2012, OPI had no business activities or material assets. In June 2011, the Company formed Oasis Well Services LLC (OWS), a Delaware limited liability company, to provide well services to OPNA. In July 2011, the Company formed Oasis Petroleum Marketing LLC (OPM), a Delaware limited liability company, to provide marketing services to OPNA.

Nature of Business

The Company is an independent exploration and production company focused on the acquisition and development of unconventional oil and natural gas resources in the Williston Basin. The Company s proved and unproved oil and natural gas properties are located in the Montana and North Dakota areas of the Williston Basin and are owned by OPNA. The Company also operates businesses that are complementary to its primary development and production activities, including a marketing business (OPM) and a well services business (OWS).

2. Summary of Significant Accounting Policies

Basis of Presentation

The accompanying condensed consolidated financial statements of the Company include the accounts of Oasis and its wholly owned subsidiaries: OP LLC, OPNA, OPI, OWS and OPM. The accompanying condensed consolidated financial statements of the Company have not been audited by the Company s independent registered public accounting firm, except that the condensed consolidated balance sheet at December 31, 2011 is derived from audited financial statements. All significant intercompany transactions have been eliminated in consolidation. Certain reclassifications of prior year balances have been made to conform such amounts to current year classifications. These reclassifications have no impact on net income. In the opinion of management, all adjustments, consisting of normal recurring adjustments, necessary for the fair presentation have been included. In preparing the accompanying condensed consolidated financial statements, management has made certain estimates and assumptions that affect reported amounts in the condensed consolidated financial statements and disclosures of contingencies. Actual results may differ from those estimates. The results for interim periods are not necessarily indicative of annual results.

These interim financial statements have been prepared pursuant to the rules and regulations of the Securities and Exchange Commission (SEC) regarding interim financial reporting. Certain disclosures have been condensed or omitted from these financial statements. Accordingly, they do not include all of the information and notes required by accounting principles generally accepted in the United States of America (GAAP) for complete consolidated financial statements and should be read in conjunction with the Company s audited consolidated financial statements and notes thereto included in the Company s Annual Report on Form 10-K for the year ended December 31, 2011 (2011 Annual Report).

Significant Accounting Policies

There have been no material changes to the Company s critical accounting policies and estimates from those disclosed in the 2011 Annual Report other than those noted below.

Stock-Based Compensation Performance Share Units

The Company recognizes compensation expense for its performance share units (PSUs) granted to its officers. Stock-based compensation expense is measured at the grant date based on the fair value of the award and is recognized as expense on a straight-line basis over the performance period, which is generally the vesting period. The fair value of the PSUs is based on the calculation derived from a Monte Carlo simulation model. The Monte Carlo simulation model uses assumptions regarding random projections and must be repeated numerous times to achieve a probable assessment. Any change in inputs or number of inputs to this calculation could impact the valuation and thus the stock-based compensation expense recognized. Stock-based compensation expense recorded for PSUs is included in general and administrative expenses on the Company s Condensed Consolidated Statement of Operations.

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Recent Accounting Pronouncements

Intangible assets. In July 2012, the Financial Accounting Standards Board (FASB) issued Accounting Standards Update No. 2012-02, *Intangibles Goodwill and Other Testing Indefinite-Lived Intangible Assets for Impairment* (ASU 2012-02). The objective of ASU 2012-02 is to reduce the cost and complexity of performing an impairment test for indefinite-lived intangible assets by permitting an entity first to assess qualitative factors to determine whether it is more likely than not that an indefinite-lived intangible asset is impaired, as a basis for determining whether it is necessary to perform a quantitative impairment test. ASU 2012-02 is effective for interim and annual reporting periods beginning after September 15, 2012. The Company does not expect the adoption of this new guidance to have any impact on its financial position, cash flows or results of operations.

3. Inventory

Equipment and materials consist primarily of tubular goods, well equipment to be used in future drilling or repair operations and well fracturing equipment, all of which are stated at the lower of cost or market with cost determined on an average cost method. Crude oil inventories include oil in tank and line fill and are valued at the lower of average cost or market value. Inventory consists of the following:

	September 30, 2012	December 31, 2011
	(In thousands)	
Equipment and materials	$ 15,846	$ 2,709
Crude oil inventory	5,296	834
Total inventory	$ 21,142	$ 3,543

4. Property, Plant and Equipment

The following table sets forth the Company s property, plant and equipment:

	September 30, 2012	December 31, 2011
	(In thousands)	
Proved oil and gas properties (1)	$ 2,004,433	$ 1,152,532
Less: Accumulated depreciation, depletion, amortization and impairment	(314,787)	(174,948)
Proved oil and gas properties, net	1,689,646	977,584
Unproved oil and gas properties	74,583	82,825
Oil and gas properties, net	1,764,229	1,060,409
Other property and equipment	45,261	20,859
Less: Accumulated depreciation	(5,691)	(1,313)
Other property and equipment, net	39,570	19,546
Total property, plant and equipment, net	$ 1,803,799	$ 1,079,955

(1) Included in the Company s proved oil and gas properties are estimates of future asset retirement costs of $18.5 million and $11.4 million at September 30, 2012 and December 31, 2011, respectively. In addition, the Company s proved oil and gas properties include cumulative capitalized interest of $5.6 million and $3.1 million at September 30, 2012 and December 31, 2011, respectively.

As a result of expiring leases and periodic assessments of unproved properties, the Company recorded non-cash impairment charges on its unproved oil and gas properties of $36,000 and $2.6 million for the three and nine months ended September 30, 2012, respectively, and $0.4 million and $3.3 million for the three and nine months ended September 30, 2011, respectively. No impairment charges on proved oil and natural gas properties were recorded for the three and nine months ended September 30, 2012 or 2011.

5. Fair Value Measurements

In accordance with the FASB s authoritative guidance on fair value measurements, the Company s financial assets and liabilities are measured at fair value on a recurring basis. The Company recognizes its non-financial assets and liabilities, such as asset retirement obligations and proved oil and natural gas properties upon impairment, at fair value on a non-recurring basis.

As defined in the authoritative guidance, fair value is the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date (exit price). To estimate fair value, the Company utilizes market data or assumptions that market participants would use in pricing the asset or liability, including assumptions about risk and the risks inherent in the inputs to the valuation technique. These inputs can be readily observable, market corroborated or generally unobservable.

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The authoritative guidance establishes a fair value hierarchy that prioritizes the inputs used to measure fair value. The hierarchy gives the highest priority to unadjusted quoted prices in active markets for identical assets or liabilities (Level 1 measurements) and the lowest priority to unobservable inputs (Level 3 measurements). The three levels of the fair value hierarchy are as follows:

Level 1 Unadjusted quoted prices are available in active markets for identical assets or liabilities as of the reporting date. Active markets are those in which transactions for the asset or liability occur in sufficient frequency and volume to provide pricing information on an ongoing basis.

Level 2 Pricing inputs, other than unadjusted quoted prices in active markets included in Level 1, are either directly or indirectly observable as of the reporting date. Level 2 includes those financial instruments that are valued using models or other valuation methodologies. These models are primarily industry-standard models that consider various assumptions, including quoted forward prices for commodities, time value, volatility factors and current market and contractual prices for the underlying instruments, as well as other relevant economic measures. Substantially all of these assumptions are observable in the marketplace throughout the full term of the instrument and can be derived from observable data or are supported by observable levels at which transactions are executed in the marketplace.

Level 3 Pricing inputs are generally less observable from objective sources, requiring internally developed valuation methodologies that result in management s best estimate of fair value.

Financial Assets and Liabilities

As required, financial assets and liabilities are classified in their entirety based on the lowest level of input that is significant to the fair value measurement. The Company s assessment of the significance of a particular input to the fair value measurement requires judgment and may affect the valuation of fair value assets and liabilities and their placement within the fair value hierarchy levels. The following tables set forth by level within the fair value hierarchy the Company s financial assets and liabilities that were accounted for at fair value on a recurring basis:

	At fair value as of September 30, 2012			
	Level 1	Level 2	Level 3	Total
	(In thousands)			
Assets:				
Money market funds	$ 165,737	$	$	$ 165,737
Commodity derivative instruments (see Note 6)		27,367		27,367
Total assets	$ 165,737	$ 27,367	$	$ 193,104
Liabilities:				
Commodity derivative instruments (see Note 6)	$	$ 1,633	$	$ 1,633
Total liabilities	$	$ 1,633	$	$ 1,633

	At fair value as of December 31, 2011			
	Level 1	Level 2	Level 3	Total
	(In thousands)			
Assets:				
Money market funds	$ 250,419	$	$	$ 250,419
Commodity derivative instruments (see Note 6)			4,362	4,362
Total assets	$ 250,419	$	$ 4,362	$ 254,781
Liabilities:				
Commodity derivative instruments (see Note 6)	$	$	$ 9,412	$ 9,412
Total liabilities	$	$	$ 9,412	$ 9,412

The Level 1 instruments presented in the tables above consist of money market funds included in cash and cash equivalents on the Company s Condensed Consolidated Balance Sheet at September 30, 2012 and December 31, 2011. The Company s money market funds represent cash equivalents backed by the assets of high-quality major banks and financial institutions. The Company identified the money market funds as Level 1 instruments due to the fact that the money market funds have daily liquidity, quoted prices for the underlying investments can be obtained and there are active markets for the underlying investments.

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The Level 2 and Level 3 instruments presented in the tables above consist of oil collars, swaps and puts. The fair values of the Company s oil collars, swaps and puts are based upon a third-party preparer s calculation using mark-to-market valuation reports provided by the Company s counterparties for monthly settlement purposes to determine the valuation of its derivative instruments. The Company has the third-party preparer evaluate other readily available market prices for its derivative contracts as there is an active market for these contracts. The third-party preparer performs its independent valuation using an options pricing model similar to Black-Scholes. The significant inputs used are crude oil prices, volatility, skew, discount rate and the contract terms of the derivative instruments. However, the Company does not have access to the specific proprietary valuation models or inputs used by its counterparties or third-party preparer. The determination of the fair values also incorporates a credit adjustment for non-performance risk, as required by GAAP. The Company calculated the credit adjustment for derivatives in an asset position using current credit default swap values for each counterparty. The credit adjustment for derivatives in a liability position is based on the Company s market credit spread. Based on these calculations, the Company recorded a downward adjustment to the fair value of its net derivative asset in the amount of $39,000 at September 30, 2012 and a downward adjustment to the fair value of its net derivative liability in the amount of $0.3 million at December 31, 2011.

The Company has adopted the FASB s authoritative guidance amending certain accounting and disclosure requirements related to fair value measurements. The guidance clarifies and modifies some fair value measurement principles under GAAP, including a change in the valuation premise and the application of premiums and discounts, and contains some new disclosure requirements under GAAP. The guidance had no impact on the Company s financial position, cash flows or results of operations for the nine months ended September 30, 2012.

The following table presents a reconciliation of the changes in fair value of the derivative instruments classified as Level 3 in the fair value hierarchy for the periods presented.

	2012	2011
	(In thousands)	
Balance as of January 1	$ (5,050)	$ (10,486)
Total gains or (losses) (realized or unrealized):		
Included in earnings		67,105
Included in other comprehensive income		
Settlements		4,831
Transfers in and out of Level 3 (1)	5,050	
Balance as of September 30	$	$ 61,450
Change in unrealized losses included in earnings relating to derivatives still held at September 30	$	$ 71,936

(1) During the first nine months of 2012, the inputs used to value the Company s commodity derivative instruments were directly or indirectly observable and those contracts were transferred to Level 2.

Fair Value of Other Financial Instruments

The Company s financial instruments, including certain cash and cash equivalents, short-term investments, accounts receivable and accounts payable, are carried at amortized cost, which approximates cost and fair value due to the short-term maturity of these instruments. At September 30, 2012, the Company s cash equivalents and short-term investments were all Level 1 assets. The carrying amount of the Company s long-term debt (senior unsecured notes due 2019, 2021 and 2023 see Note 7) reported in the Condensed Consolidated Balance Sheet at September 30, 2012 is $1,200.0 million with a fair value of $1,276.0 million. The Company s senior unsecured notes are publicly traded and therefore categorized as a Level 1 liability.

Nonfinancial Assets and Liabilities

Asset retirement obligations. The carrying amount of the Company s asset retirement obligations (ARO) in the Condensed Consolidated Balance Sheet at September 30, 2012 is $20.8 million (see Note 8 Asset Retirement Obligations). The Company determines the ARO by calculating the present value of estimated cash flows related to the liability. Estimating the future ARO requires management to make estimates and judgments regarding timing and existence of a liability, as well as what constitutes adequate restoration. Inherent in the fair value calculation are numerous assumptions and judgments, including the ultimate costs, inflation factors, credit adjusted discount rates, timing of settlement and changes in the legal, regulatory, environmental and political environments. These assumptions represent Level 3 inputs. To the extent future revisions to these assumptions impact the fair value of the existing ARO liability, a corresponding adjustment is made to the related asset.

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Impairment. The Company reviews its proved oil and natural gas properties for impairment whenever events and circumstances indicate that a decline in the recoverability of their carrying value may have occurred. The Company estimates the expected undiscounted future cash flows of its oil and natural gas properties and compares such undiscounted future cash flows to the carrying amount of the oil and natural gas properties to determine if the carrying amount is recoverable. If the carrying amount exceeds the estimated undiscounted future cash flows, the Company will adjust the carrying amount of the oil and natural gas properties to fair value. The factors used to determine fair value are subject to management s judgment and expertise and include, but are not limited to, recent sales prices of comparable properties, the present value of future cash flows, net of estimated operating and development costs using estimates of proved reserves, future commodity pricing, future production estimates, anticipated capital expenditures and various discount rates commensurate with the risk and current market conditions associated with realizing the expected cash flows projected. These assumptions represent Level 3 inputs. No impairment charges on proved oil and natural gas properties were recorded for the three and nine months ended September 30, 2012 or 2011.

6. Derivative Instruments

The Company utilizes derivative financial instruments to manage risks related to changes in oil prices. As of September 30, 2012, the Company utilized two-way and three-way collar options, swaps and put spreads to reduce the volatility of oil prices on a significant portion of the Company s future expected oil production. All derivative instruments are recorded on the balance sheet as either assets or liabilities measured at fair value (see Note 5 Fair Value Measurements). Derivative assets and liabilities arising from the Company s derivative contracts with the same counterparty are also reported on a net basis, as all counterparty contracts provide for net settlement. The Company has not designated any derivative instruments as hedges for accounting purposes and does not enter into such instruments for speculative trading purposes. If a derivative does not qualify as a hedge or is not designated as a hedge, the changes in fair value, both realized and unrealized, are recognized in the Other Income (Expense) section of the Condensed Consolidated Statement of Operations as a gain or loss on derivative instruments. The Company s cash flow is only impacted when the actual settlements under the derivative contracts result in making or receiving a payment to or from the counterparty. These cash settlements are reflected as investing activities in the Company s Condensed Consolidated Statement of Cash Flows.

As of September 30, 2012, the Company had the following outstanding commodity derivative instruments, all of which settle monthly based on the average West Texas Intermediate crude oil index price:

Settlement Period	Derivative Instrument	Total Notional Amount of Oil (Barrels)	Average Swap Price	Average Sub-Floor Price	Average Floor Price	Average Ceiling Price	Fair Value Asset (Liability) (In thousands)
2012	Two-Way Collars	819,000			$ 88.61	$ 105.59	$ 975
2012	Three-Way Collars	910,000		$ 66.25	$ 90.25	$ 110.04	841
2012	Swaps	91,000	$ 94.61				130
2013	Two-Way Collars	1,782,000			$ 86.50	$ 98.93	(1,164)
2013	Three-Way Collars	2,023,420		$ 65.30	$ 92.51	$ 112.63	8,561
2013	Put Spreads	1,717,080		$ 70.71	$ 91.24		9,931
2013	Swaps	699,000	$ 96.41				1,850
2014	Two-Way Collars	139,500			$ 86.11	$ 97.69	(84)
2014	Three-Way Collars	1,495,030		$ 70.60	$ 91.43	$ 110.30	3,229
2014	Put Spreads	150,970		$ 71.03	$ 91.03		1,019
2014	Swaps	62,000	$ 96.49				215
2015	Three-Way Collars	124,000		$ 71.25	$ 91.25	$ 109.96	231
							$ 25,734

The following table summarizes the location and fair value of all outstanding commodity derivative instruments recorded in the balance sheet for the periods presented:

Fair Value of Derivative Instrument Assets (Liabilities)

Commodity	Balance Sheet Location		Fair Value September 30, 2012	Fair Value December 31, 2011
			(In thousands)	
Crude oil	Derivative instruments	current assets	$ 17,320	$
Crude oil	Derivative instruments	non-current assets	10,047	4,362
Crude oil	Derivative instruments	current liabilities	(1,273)	(5,907)
Crude oil	Derivative instruments	non-current liabilities	(360)	(3,505)
Total derivative instruments			$ 25,734	$ (5,050)

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The following table summarizes the location and amounts of realized and unrealized gains and losses from the Company s commodity derivative instruments for the periods presented:

	Income Statement Location	Three Months Ended September 30, 2012	Three Months Ended September 30, 2011	Nine Months Ended September 30, 2012	Nine Months Ended September 30, 2011
		(In thousands)		(In thousands)	
Change in unrealized gain (loss) on derivative instruments	Net gain (loss) on derivative instruments	$ (27,690)	$ 71,403	$ 30,784	$ 71,936
Realized gain (loss) on derivative instruments	Net gain (loss) on derivative instruments	5,249	(179)	2,784	(4,831)
Total net gain (loss) on derivative instruments		$ (22,441)	$ 71,224	$ 33,568	$ 67,105

7. Long-Term Debt

Senior unsecured notes. On July 2, 2012, the Company issued $400.0 million of 6.875% senior unsecured notes due January 15, 2023 (the 2023 Notes). During 2011, the Company issued $400.0 million of 7.25% senior unsecured notes due February 1, 2019 (the 2019 Notes) and $400.0 million of 6.5% senior unsecured notes due November 1, 2021 (the 2021 Notes , and together with the 2023 Notes and the 2019 Notes, the Notes). Interest on the Notes is payable semi-annually in arrears. The Notes are guaranteed on a senior unsecured basis by the Company s material subsidiaries (the Guarantors). These guarantees are full and unconditional and joint and several among the Guarantors. The issuance of these Notes resulted in aggregate net proceeds to the Company of approximately $1,175.8 million, including $392.4 million on July 2, 2012 for the 2023 Notes and $783.4 during the year ended December 31, 2011 for the 2019 Notes and the 2021 Notes.

The Notes were issued under indentures containing provisions that are substantially the same, as amended and supplemented by supplemental indentures (collectively the Indentures), among the Company, the Guarantors and U.S. Bank National Association, as trustee (the Trustee). The Company has certain options to redeem up to 35% of the Notes at a certain redemption price based on a percentage of the principal amount, plus accrued and unpaid interest to the redemption date, with the proceeds of certain equity offerings so long as the redemption occurs within 180 days of completing such equity offering and at least 65% of the aggregate principal amount of the Notes remains outstanding after such redemption. Prior to certain dates, the Company has the option to redeem some or all of the Notes for cash at certain redemption prices equal to a certain percentage of their principal amount plus an applicable make-whole premium and accrued and unpaid interest to the redemption date. The Company estimates that the fair value of these options is immaterial at September 30, 2012.

The Indentures restrict the Company s ability and the ability of certain of its subsidiaries to: (i) incur additional debt or enter into sale and leaseback transactions; (ii) pay distributions on, redeem or repurchase equity interests; (iii) make certain investments; (iv) incur liens; (v) enter into transactions with affiliates; (vi) merge or consolidate with another company; and (vii) transfer and sell assets. These covenants are subject to certain exceptions and qualifications. If at any time when the Notes are rated investment grade by both Moody s Investors Service, Inc. and Standard & Poor s Ratings Services and no Default (as defined in the Indentures) has occurred and is continuing, many of such covenants will terminate and the Company and its subsidiaries will cease to be subject to such covenants.

The Indentures contain customary events of default, including:

- default in any payment of interest on any Note when due, continued for 30 days;

- default in the payment of principal or premium, if any, on any Note when due;

- failure by the Company to comply with its other obligations under the Indentures, in certain cases subject to notice and grace periods;

payment defaults and accelerations with respect to other indebtedness of the Company and its Restricted Subsidiaries (as defined in the Indentures) in the aggregate principal amount of $10.0 million or more;

certain events of bankruptcy, insolvency or reorganization of the Company or a Significant Subsidiary (as defined in the Indentures) or group of Restricted Subsidiaries that, taken together, would constitute a Significant Subsidiary;

failure by the Company or any Significant Subsidiary or group of Restricted Subsidiaries that, taken together, would constitute a Significant Subsidiary to pay certain final judgments aggregating in excess of $10.0 million within 60 days; and

any guarantee of the Notes by a Guarantor ceases to be in full force and effect, is declared null and void in a judicial proceeding or is denied or disaffirmed by its maker.

Senior secured revolving line of credit. OP LLC, as parent, and OPNA, as borrower, entered into a credit agreement dated June 22, 2007 (as amended and restated, the Amended Credit Facility). The Amended Credit Facility is restricted to the borrowing base, which is reserve-based and subject to semi-annual redeterminations on April 1 and October 1 of each year. Borrowings under the Amended Credit Facility are collateralized by perfected first priority liens and security interests on substantially all of the Company s assets, including mortgage liens on oil and natural gas properties having at least 80% of the reserve value as determined by reserve reports. On April 3, 2012, the Company entered into its sixth amendment to its Amended Credit Facility. This amendment added two new lenders to the bank group. All other terms and conditions of the Amended Credit Facility remained the same, including the October 6, 2016 maturity date and the $1 billion senior secured revolving line of credit. In connection with the sixth amendment, the semi-annual redetermination of the borrowing base was also completed on April 3, 2012, which resulted in the borrowing base of the Amended Credit Facility increasing from $350 million to $500 million. Effective April 20, 2012, the Company executed an agreement consenting to the resignation of BNP Paribas as the administrative agent and a lender under the Amended Credit Facility. Wells Fargo was appointed successor administrative agent and assumed the credit commitment of BNP Paribas. BNP Paribas remains as a counterparty for the Company s commodity derivative instruments. On June 25, 2012, the Company s lenders waived the mandatory reduction of the Company s borrowing base that otherwise would have occurred as a result of the Company s issuance of the 2023 Notes in July 2012. In addition, on October 2, 2012, the Company entered into its seventh amendment to its Amended Credit Facility (see Note 14 Subsequent Events).

Borrowings under the Amended Credit Facility are subject to varying rates of interest based on (1) the total outstanding borrowings (including the value of all outstanding letters of credit) in relation to the borrowing base and (2) whether the loan is a London interbank offered rate (LIBOR) loan or a domestic bank prime interest rate loan (defined in the Amended Credit Facility as an Alternate Based Rate or ABR loan). As of September 30, 2012, any outstanding LIBOR and ABR loans would have borne their respective interest rates plus the applicable margin indicated in the following table:

Ratio of Total Outstanding Borrowings to Borrowing Base	Applicable Margin for LIBOR Loans	Applicable Margin for ABR Loans
Less than .25 to 1	1.50%	0.00%
Greater than or equal to .25 to 1 but less than .50 to 1	1.75%	0.25%
Greater than or equal to .50 to 1 but less than .75 to 1	2.00%	0.50%
Greater than or equal to .75 to 1 but less than .90 to 1	2.25%	0.75%
Greater than .90 to 1 but less than or equal 1	2.50%	1.00%

An ABR loan may be repaid at any time before the scheduled maturity of the Amended Credit Facility upon the Company providing advance notification to the lenders under the Amended Credit Facility (the Lenders). Interest is paid quarterly on ABR loans based on the number of days an ABR loan is outstanding as of the last business day in March, June, September and December. The Company has the option to convert an ABR loan to a LIBOR-based loan upon providing advance notification to the Lenders. The minimum available loan term is one month and the maximum loan term is six months for LIBOR-based loans. Interest for LIBOR loans is paid upon maturity of the loan term. Interim interest is paid every three months for LIBOR loans that have loan terms greater than three months in duration. At the end of a LIBOR loan term, the Amended Credit Facility allows the Company to elect to repay the borrowing, continue a LIBOR loan with the same or a differing loan term or convert the borrowing to an ABR loan.

On a quarterly basis, the Company also pays a 0.375% annualized commitment fee on the average amount of borrowing base capacity not utilized during the quarter and fees calculated on the average amount of letter of credit balances outstanding during the quarter.

As of September 30, 2012, the Amended Credit Facility contained covenants that included, among others:

a prohibition against incurring debt, subject to permitted exceptions;

a prohibition against making dividends, distributions and redemptions, subject to permitted exceptions;

a prohibition against making investments, loans and advances, subject to permitted exceptions;

restrictions on creating liens and leases on the assets of the Company and its subsidiaries, subject to permitted exceptions;

restrictions on merging and selling assets outside the ordinary course of business;

restrictions on use of proceeds, investments, transactions with affiliates or change of principal business;

a provision limiting oil and natural gas derivative financial instruments;

a requirement that the Company not allow a ratio of Total Net Debt (as defined in the Amended Credit Facility) to consolidated EBITDAX (as defined in the Amended Credit Facility) to be greater than 4.0 to 1.0 for the four quarters ended on the last day of each quarter; and

a requirement that the Company maintain a Current Ratio (as defined in the Amended Credit Facility) of consolidated current assets (with exclusions as described in the Amended Credit Facility) to consolidated current liabilities (with exclusions as described in the Amended Credit Facility) of not less than 1.0 to 1.0 as of the last day of any fiscal quarter.

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The Amended Credit Facility contains customary events of default. If an event of default occurs and is continuing, the Lenders may declare all amounts outstanding under the Amended Credit Facility to be immediately due and payable.

As of September 30, 2012, the Company had no borrowings and no outstanding letters of credit issued under the Amended Credit Facility, resulting in an unused borrowing base capacity of $500 million. The Company was in compliance with the financial covenants of the Amended Credit Facility as of September 30, 2012.

Deferred financing costs. As of September 30, 2012, the Company had $24.3 million of deferred financing costs related to the Amended Credit Facility and the senior unsecured notes. The deferred financing costs are included in deferred costs and other assets on the Company s Condensed Consolidated Balance Sheet at September 30, 2012 and are being amortized over the respective terms of the Amended Credit Facility and the senior unsecured notes. The amortization of these deferred financing costs is included in interest expense on the Company s Condensed Consolidated Statement of Operations.

8. Asset Retirement Obligations

The following table reflects the changes in the Company s ARO during the nine months ended September 30, 2012:

	(In thousands)
Balance at December 31, 2011	$ 13,075
Liabilities incurred during period	5,388
Liabilities settled during period	(42)
Accretion expense during period (1)	612
Revisions to estimates	1,774
Balance at September 30, 2012	$ 20,807

(1) Included in depreciation, depletion and amortization on the Company s Condensed Consolidated Statement of Operations.
The revisions to estimates were primarily due to changes in the estimated useful lives of certain wells. At September 30, 2012, the current portion of the total ARO balance was approximately $0.3 million and is included in accrued liabilities on the Company s Condensed Consolidated Balance Sheet.

9. Stock-Based Compensation

Performance share units. On July 30, 2012, the Company s Board of Directors approved grants of performance share units (PSUs) to officers of the Company pursuant to the Company s 2010 Long Term Incentive Plan. The PSUs are awards of restricted stock units, and each PSU that is earned represents the right to receive one share of the Company s common stock.

The PSUs are subject to a designated three-year initial performance period beginning on August 1, 2012 and ending on July 31, 2015. The number of PSUs to be earned is subject to a market condition, which is based on a comparison of the total shareholder return (TSR) achieved with respect to shares of the Company s common stock against the TSR achieved by a defined peer group. Depending on the Company s performance relative to the defined peer group, an award recipient will earn between 0% and 200% of the initial PSUs granted. If less than 200% of the initial PSUs granted are earned at the end of the initial performance period, then the performance period will be extended to July 16, 2016 to give the recipient the opportunity to earn up to an aggregate of 200% of the initial PSUs granted.

The following table summarizes information related to PSUs held by the Company s officers at September 30, 2012:

	Initial Unit Awards
Non-vested PSUs at December 31, 2011	

Granted	155,220
Vested	
Forfeited	
Non-vested PSUs at September 30, 2012	155,220

The Company accounted for these PSUs as equity awards pursuant to the FASB s authoritative guidance for share-based payments. The aggregate grant date fair value of the market-based awards was determined using a Monte Carlo simulation model. The fair value of these PSUs is recognized on a straight-line basis over the performance period. As it is probable that a portion of the awards will be earned during the extended performance period, the grant date fair value will be amortized over four years. However, if 200% of the initial PSUs granted are earned at the end of the initial performance period, then the remaining compensation expense will be accelerated in order to be fully recognized over three years. All compensation expense related to the PSUs will be recognized if the requisite performance period is fulfilled, even if the market condition is not achieved.

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The Monte Carlo simulation model uses assumptions regarding random projections and must be repeated numerous times to achieve a probabilistic assessment. The key valuation assumptions for the Monte Carlo model are the forecast period, initial value, risk-free rate, volatility and correlation coefficients. The risk-free rate is the U.S. treasury rate on the date of grant. The initial value is the average of the volume weighted average prices for the 30 trading days prior to the start of the performance cycle for the Company and each of its peers. Volatility is the standard deviation of the average percentage in stock price over a historical two-year period for the Company and each of its peers. The correlation coefficients are measures of the strength of the linear relationship between and amongst the Company and its peers estimated based on historical stock price data. No forfeiture rate is assumed for these types of awards.

The following assumptions were used as of September 30, 2012 for the Monte Carlo model to value the stock-based compensation expense of the PSUs granted:

	2012 PSUs
Forecast period (years)	4.01
Risk-free rate	0.46%
Oasis volatility	51.00%

The fair value per PSU at September 30, 2012 was $26.22. Stock-based compensation expense recorded for these PSUs for both the three and nine months ended September 30, 2012 was $0.2 million and is included in general and administrative expenses on the Condensed Consolidated Statement of Operations. Unrecognized expense as of September 30, 2012 for all outstanding PSUs was $3.9 million and will be recognized over a four-year requisite service period. No stock-based compensation expense was recorded for the three or nine months ended September 30, 2011 as the Company had not issued PSUs prior to July 2012.

10. Income Taxes

The Company s effective tax rate for the three and nine months ended September 30, 2012 was 38.5% and 37.6%, respectively, and was 37.0% and 37.2% for the three and nine months ended September 30, 2011, respectively. These rates were consistent with the statutory tax rate applicable to the U.S. and the blended state rate for the states in which the Company conducts business. As of September 30, 2012, the Company did not have any uncertain tax positions requiring adjustments to its tax liability.

The Company had deferred tax assets for its federal and state tax loss carryforwards at September 30, 2012 recorded in noncurrent deferred taxes. Deferred tax assets are reduced by a valuation allowance when, in the opinion of management, it is more likely than not that some portion or all of the deferred tax assets will not be realized. As of September 30, 2012, management determined that a valuation allowance was not required for the tax loss carryforwards as they are expected to be fully utilized before expiration.

11. Earnings Per Share

Basic earnings per share is computed by dividing income available to common stockholders by the weighted average number of shares outstanding for the periods presented. The calculation of diluted earnings per share includes the impact of potentially dilutive non-vested restricted shares outstanding during the periods presented, unless their effect is anti-dilutive. There are no adjustments made to income available to common stockholders in the calculation of diluted earnings per share.

The following is a calculation of the basic and diluted weighted-average shares outstanding for the three and nine months ended September 30, 2012 and 2011:

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2012	2011	2012	2011
	(In thousands)		(In thousands)	
Basic weighted average common shares outstanding	92,186	92,060	92,164	92,052
Dilution effect of stock awards at end of period	230	104	179	156
Diluted weighted average common shares outstanding	92,416	92,164	92,343	92,208

Anti-dilutive stock-based compensation awards	748	281	541	174

12. Commitments and Contingencies

Lease obligations. The Company s total rental commitments under leases for office space and other property and equipment at September 30, 2012 were $14.0 million.

Drilling contracts. As of September 30, 2012, the Company had certain drilling rig contracts with initial terms greater than one year. In the event of early contract termination under these contracts, the Company would be obligated to pay approximately $50.4 million as of September 30, 2012 for the days remaining through the end of the primary terms of the contracts.

Volume commitment agreements. As of September 30, 2012, the Company had certain agreements with an aggregate requirement to deliver a minimum quantity of approximately 24.7 MMBbl and 15.7 Bcf from its Williston Basin project areas within a specified timeframe. Future obligations under these agreements were approximately $75.4 million as of September 30, 2012.

Litigation. The Company is party to various legal and/or regulatory proceedings from time to time arising in the ordinary course of business. The Company believes all such matters are without merit and involve amounts which, if resolved unfavorably, either individually or in the aggregate, will not have a material adverse effect on its financial condition, results of operations or cash flows.

13. Condensed Consolidating Financial Information

The Notes (see Note 7) are guaranteed on a senior unsecured basis by the Guarantors, which are 100% owned by the Company. These guarantees are full and unconditional and joint and several among the Guarantors. Certain of the Company s immaterial wholly owned subsidiaries do not guarantee the Notes (Non-Guarantor Subsidiaries).

The following financial information reflects consolidating financial information of the Company (Issuer) and its Guarantors on a combined basis, prepared on the equity basis of accounting. The Non-Guarantor Subsidiaries are immaterial and, therefore, not presented separately. The information is presented in accordance with the requirements of Rule 3-10 under the SEC s Regulation S-X. The financial information may not necessarily be indicative of results of operations, cash flows or financial position had the Guarantors operated as independent entities. The Company has not presented separate financial and narrative information for each of the Guarantors because it believes such financial and narrative information would not provide any additional information that would be material in evaluating the sufficiency of the Guarantors. The consolidating statement of cash flows for the nine months ended September 30, 2011 includes a revision in presentation in the Issuer column, which increased cash flows from operating activities by $105.8 million and reduced cash flows from financing activities by the same amount. These revisions are eliminated in consolidation and have no effect on the Guarantors or consolidated financial statements.

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Condensed Consolidating Balance Sheet

(In thousands, except share data)

	September 30, 2012			
	Parent/ Issuer	Combined Guarantor Subsidiaries	Intercompany Eliminations	Consolidated
ASSETS				
Current assets				
Cash and cash equivalents	$ 231,170	$ 49,133	$	$ 280,303
Short-term investments	126,213			126,213
Accounts receivable oil and gas revenues		104,965		104,965
Accounts receivable joint interest partners		83,630		83,630
Accounts receivable from affiliates	291	3,559	(3,850)	
Inventory		21,142		21,142
Prepaid expenses	501	3,529		4,030
Advances to joint interest partners		4,025		4,025
Derivative instruments		17,320		17,320
Other current assets	78			78
Total current assets	358,253	287,303	(3,850)	641,706
Property, plant and equipment				
Oil and gas properties (successful efforts method)		2,079,016		2,079,016
Other property and equipment		45,261		45,261
Less: accumulated depreciation, depletion, amortization and impairment		(320,478)		(320,478)
Total property, plant and equipment, net		1,803,799		1,803,799
Investments in and advances to subsidiaries	1,563,143		(1,563,143)	
Derivative instruments		10,047		10,047
Deferred income taxes	33,616		(33,616)	
Deferred costs and other assets	21,405	3,944		25,349
Total assets	$ 1,976,417	$ 2,105,093	$ (1,600,609)	$ 2,480,901
LIABILITIES AND STOCKHOLDERS EQUITY				
Current liabilities				
Accounts payable	$ 4	$ 30,950	$	$ 30,954
Accounts payable from affiliates	3,559	291	(3,850)	
Advances from joint interest partners		26,572		26,572
Revenues and production taxes payable		64,091		64,091
Accrued liabilities	25	200,519		200,544
Accrued interest payable	22,465	16		22,481
Derivative instruments		1,273		1,273
Deferred income taxes		3,782		3,782
Other current liabilities		5,256		5,256
Total current liabilities	26,053	332,750	(3,850)	354,953
Long-term debt	1,200,000			1,200,000
Asset retirement obligations		20,529		20,529
Derivative instruments		360		360

Deferred income taxes		186,233	(33,616)	152,617
Other liabilities		2,078		2,078
Total liabilities	1,226,053	541,950	(37,466)	1,730,537
Stockholders equity				
Capital contributions from affiliates		1,400,817	(1,400,817)	
Common stock, $0.01 par value; 300,000,000 shares authorized; 93,435,593 issued and 93,369,468 outstanding	923			923
Treasury stock, at cost; 66,125 shares	(1,901)			(1,901)
Additional paid-in-capital	653,999	8,743	(8,743)	653,999
Retained earnings	97,343	153,583	(153,583)	97,343
Total stockholders equity	750,364	1,563,143	(1,563,143)	750,364
Total liabilities and stockholders equity	$ 1,976,417	$ 2,105,093	$ (1,600,609)	$ 2,480,901

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Condensed Consolidating Balance Sheet

(In thousands, except share data)

	December 31, 2011			
	Parent/ Issuer	Combined Guarantor Subsidiaries	Intercompany Eliminations	Consolidated
ASSETS				
Current assets				
Cash and cash equivalents	$ 443,482	$ 27,390	$	$ 470,872
Short-term investments	19,994			19,994
Accounts receivable oil and gas revenues		52,164		52,164
Accounts receivable joint interest partners		67,268		67,268
Accounts receivable from affiliates	88	1,540	(1,628)	
Inventory		3,543		3,543
Prepaid expenses	309	1,831		2,140
Advances to joint interest partners		3,935		3,935
Deferred income taxes		3,233		3,233
Other current assets	18	473		491
Total current assets	463,891	161,377	(1,628)	623,640
Property, plant and equipment				
Oil and gas properties (successful efforts method)		1,235,357		1,235,357
Other property and equipment		20,859		20,859
Less: accumulated depreciation, depletion, amortization and impairment		(176,261)		(176,261)
Total property, plant and equipment, net		1,079,955		1,079,955
Investments in and advances to subsidiaries	958,880		(958,880)	
Derivative instruments		4,362		4,362
Deferred income taxes	13,158		(13,158)	
Deferred costs and other assets	15,742	3,683		19,425
Total assets	$ 1,451,671	$ 1,249,377	$ (973,666)	$ 1,727,382
LIABILITIES AND STOCKHOLDERS EQUITY				
Current liabilities				
Accounts payable	$ 23	$ 12,184	$	$ 12,207
Accounts payable from affiliates	1,540	88	(1,628)	
Advances from joint interest partners		9,064		9,064
Revenues and production taxes payable		19,468		19,468
Accrued liabilities	103	119,589		119,692
Accrued interest payable	15,767	7		15,774
Derivative instruments		5,907		5,907
Other current liabilities		472		472
Total current liabilities	17,433	166,779	(1,628)	182,584
Long-term debt	800,000			800,000
Asset retirement obligations		13,075		13,075
Derivative instruments		3,505		3,505
Deferred income taxes		106,141	(13,158)	92,983

Other liabilities		997		997
Total liabilities	817,433	290,497	(14,786)	1,093,144
Stockholders equity				
Capital contributions from affiliates		941,575	(941,575)	
Common stock, $0.01 par value; 300,000,000 shares authorized; 92,483,393 issued and 92,460,914 outstanding	921			921
Treasury stock, at cost; 22,479 shares	(602)			(602)
Additional paid-in-capital	647,374	8,743	(8,743)	647,374
Retained earnings (deficit)	(13,455)	8,562	(8,562)	(13,455)
Total stockholders equity	634,238	958,880	(958,880)	634,238
Total liabilities and stockholders equity	$ 1,451,671	$ 1,249,377	$ (973,666)	$ 1,727,382

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Condensed Consolidating Statement of Operations

(In thousands)

	Three Months Ended September 30, 2012			
	Parent/ Issuer	Combined Guarantor Subsidiaries	Intercompany Eliminations	Consolidated
Revenues				
Oil and gas revenues	$	$ 178,748	$	$ 178,748
Well services revenues		5,963		5,963
Total revenues		184,711		184,711
Expenses				
Lease operating expenses		16,134		16,134
Well services operating expenses		5,420		5,420
Marketing, transportation and gathering expenses		2,744		2,744
Production taxes		16,433		16,433
Depreciation, depletion and amortization		57,684		57,684
Exploration expenses		336		336
Impairment of oil and gas properties		36		36
General and administrative expenses	2,988	10,898		13,886
Total expenses	2,988	109,685		112,673
Operating income (loss)	(2,988)	75,026		72,038
Other income (expense)				
Equity in earnings in subsidiaries	32,735		(32,735)	
Net loss on derivative instruments		(22,441)		(22,441)
Interest expense	(20,307)	(672)		(20,979)
Other income	238	909		1,147
Total other income (expense)	12,666	(22,204)	(32,735)	(42,273)
Income before income taxes	9,678	52,822	(32,735)	29,765
Income tax benefit (expense)	8,636	(20,087)		(11,451)
Net income	$ 18,314	$ 32,735	$ (32,735)	$ 18,314

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Condensed Consolidating Statement of Operations

(In thousands)

	Three Months Ended September 30, 2011			
	Parent/ Issuer	Combined Guarantor Subsidiaries	Intercompany Eliminations	Consolidated
Oil and gas revenues	$	$ 87,596	$	$ 87,596
Expenses				
Lease operating expenses		9,597		9,597
Marketing, transportation and gathering expenses		238		238
Production taxes		8,873		8,873
Depreciation, depletion and amortization		20,859		20,859
Exploration expenses		54		54
Impairment of oil and gas properties		396		396
General and administrative expenses	1,282	6,024		7,306
Total expenses	1,282	46,041		47,323
Operating income (loss)	(1,282)	41,555		40,273
Other income (expense)				
Equity in earnings in subsidiaries	71,445		(71,445)	
Net gain on derivative instruments		71,224		71,224
Interest expense	(6,495)	(291)		(6,786)
Other income	282	242		524
Total other income (expense)	65,232	71,175	(71,445)	64,962
Income before income taxes	63,950	112,730	(71,445)	105,235
Income tax benefit (expense)	2,339	(41,285)		(38,946)
Net income	$ 66,289	$ 71,445	$ (71,445)	$ 66,289

Condensed Consolidating Statement of Operations

(In thousands)

	Nine Months Ended September 30, 2012			
	Parent/ Issuer	Combined Guarantor Subsidiaries	Intercompany Eliminations	Consolidated
Revenues				
Oil and gas revenues	$	$ 461,857	$	$ 461,857
Well services revenues		10,484		10,484
Total revenues		472,341		472,341
Expenses				
Lease operating expenses		37,979		37,979

Well services operating expenses		7,104		7,104
Marketing, transportation and gathering expenses		7,283		7,283
Production taxes		43,419		43,419
Depreciation, depletion and amortization		140,783		140,783
Exploration expenses		3,171		3,171
Impairment of oil and gas properties		2,607		2,607
General and administrative expenses	8,078	31,544		39,622
Total expenses	8,078	273,890		281,968
Operating income (loss)	(8,078)	198,451		190,373
Other income (expense)				
Equity in earnings in subsidiaries	145,021		(145,021)	
Net gain on derivative instruments		33,568		33,568
Interest expense	(47,136)	(1,816)		(48,952)
Other income	533	1,988		2,521
Total other income (expense)	98,418	33,740	(145,021)	(12,863)
Income before income taxes	90,340	232,191	(145,021)	177,510
Income tax benefit (expense)	20,458	(87,170)		(66,712)
Net income	$ 110,798	$ 145,021	$ (145,021)	$ 110,798

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Condensed Consolidating Statement of Operations

(In thousands)

	Nine Months Ended September 30, 2011			
	Parent/ Issuer	Combined Guarantor Subsidiaries	Intercompany Eliminations	Consolidated
Oil and gas revenues	$	$ 213,546	$	$ 213,546
Expenses				
Lease operating expenses		21,178		21,178
Marketing, transportation and gathering expenses		797		797
Production taxes		22,041		22,041
Depreciation, depletion and amortization		47,771		47,771
Exploration expenses		345		345
Impairment of oil and gas properties		3,313		3,313
General and administrative expenses	3,863	16,007		19,870
Total expenses	3,863	111,452		115,315
Operating income (loss)	(3,863)	102,094		98,231
Other income (expense)				
Equity in earnings in subsidiaries	105,832		(105,832)	
Net gain on derivative instruments		67,105		67,105
Interest expense	(17,909)	(836)		(18,745)
Other income	946	269		1,215
Total other income (expense)	88,869	66,538	(105,832)	49,575
Income before income taxes	85,006	168,632	(105,832)	147,806
Income tax benefit (expense)	7,785	(62,800)		(55,015)
Net income	$ 92,791	$ 105,832	$ (105,832)	$ 92,791

Condensed Consolidating Statement of Cash Flows

(In thousands)

	Nine Months Ended September 30, 2012			
	Parent/ Issuer	Combined Guarantor Subsidiaries	Intercompany Eliminations	Consolidated
Cash flows from operating activities:	$ 110,798	$ 145,021	$ (145,021)	$ 110,798
Net income				
Adjustments to reconcile net income to net cash provided by (used in) operating activities:				
Equity in earnings of subsidiaries	(145,021)		145,021	
Depreciation, depletion and amortization		140,783		140,783
Impairment of oil and gas properties		2,607		2,607
Deferred income taxes	(20,458)	87,106		66,648
Derivative instruments		(33,568)		(33,568)

Stock-based compensation expenses	6,397	230		6,627
Debt discount amortization and other	1,616	422		2,038
Working capital and other changes:				
Change in accounts receivable	(203)	(70,899)	1,939	(69,163)
Change in inventory		(26,790)		(26,790)
Change in prepaid expenses	(192)	(1,817)		(2,009)
Change in other current assets	(60)	473		413
Change in other assets	(24)	(95)		(119)
Change in accounts payable and accrued liabilities	8,620	72,398	(1,939)	79,079
Change in other current liabilities		4,784		4,784
Net cash provided by (used in) operating activities	(38,527)	320,655		282,128
Cash flows from investing activities:				
Capital expenditures		(777,426)		(777,426)
Derivative settlements		2,784		2,784
Purchases of short-term investments	(126,213)			(126,213)
Redemptions of short-term investments	19,994			19,994
Advances to joint interest partners		(90)		(90)
Advances from joint interest partners		17,508		17,508
Net cash used in investing activities	(106,219)	(757,224)		(863,443)
Cash flows from financing activities:				
Proceeds from issuance of senior notes	400,000			400,000
Purchases of treasury stock	(1,299)			(1,299)
Debt issuance costs	(7,255)	(700)		(7,955)
Investment in / capital contributions from affiliates	(459,012)	459,012		
Net cash provided by (used in) financing activities	(67,566)	458,312		390,746
Decrease in cash and cash equivalents	(212,312)	21,743		(190,569)
Cash and cash equivalents at beginning of period	443,482	27,390		470,872
Cash and cash equivalents at end of period	$ 231,170	$ 49,133	$	$ 280,303

Condensed Consolidating Statement of Cash Flows

(In thousands)

	Nine Months Ended September 30, 2011			
	Parent/ Issuer	Combined Guarantor Subsidiaries	Intercompany Eliminations	Consolidated
Cash flows from operating activities:				
Net income	$ 92,791	$ 105,832	$ (105,832)	$ 92,791
Adjustments to reconcile net income to net cash provided by (used in) operating activities:				
Equity in earnings of subsidiaries	(105,832)		105,832	
Depreciation, depletion and amortization		47,771		47,771
Impairment of oil and gas properties		3,313		3,313
Deferred income taxes	(7,785)	62,800		55,015
Derivative instruments		(67,105)		(67,105)
Stock-based compensation expenses	2,592			2,592
Debt discount amortization and other	793	248		1,041
Working capital and other changes:				
Change in accounts receivable	(80)	(42,306)	1,100	(41,286)
Change in inventory		(1,850)		(1,850)
Change in prepaid expenses	(227)	(70)		(297)
Change in other current assets	(337)			(337)
Change in other assets	(100)	(3)		(103)
Change in accounts payable and accrued liabilities	5,864	43,056	(1,100)	47,820
Change in other liabilities		317		317
Net cash provided by (used in) operating activities	(12,321)	152,003		139,682
Cash flows from investing activities:				
Capital expenditures		(386,927)		(386,927)
Derivative settlements		(4,831)		(4,831)
Purchases of short-term investments	(164,913)			(164,913)
Redemptions of short-term investments	39,974			39,974
Advances to joint interest partners		(408)		(408)
Advances from joint interest partners		8,093		8,093
Net cash used in investing activities	(124,939)	(384,073)		(509,012)
Cash flows from financing activities:				
Proceeds from issuance of senior notes	400,000			400,000
Purchases of treasury stock	(562)			(562)
Debt issuance costs	(9,650)	(377)		(10,027)
Investment in / capital contributions from affiliates	(252,138)	252,138		
Net cash provided by financing activities	137,650	251,761		389,411
Increase in cash and cash equivalents	390	19,691		20,081
Cash and cash equivalents at beginning of period	119,940	23,580		143,520
Cash and cash equivalents at end of period	$ 120,330	$ 43,271	$	$ 163,601

14. Subsequent Events

The Company has evaluated the period after the balance sheet date, noting no subsequent events or transactions that required recognition or disclosure in the financial statements, other than as noted below.

Senior secured revolving line of credit. On October 2, 2012, the Company entered into its seventh amendment to its Amended Credit Facility (the Seventh Amendment). In connection with this amendment, the semi-annual redetermination of the Company s borrowing base was completed on October 2, 2012, which resulted in an increase to the borrowing base of its Amended Credit Facility from $500 million to $750 million. However, the Company elected to have the lenders aggregate commitment remain at $500 million. The Seventh Amendment provides that the Company may increase its aggregate commitment from $500 million to $750 million by increasing the commitment of one or more lender(s). The Seventh Amendment also added a requirement that the Company maintain a ratio of consolidated EBITDAX (as defined in the Amended Credit Facility) to consolidated Interest Expense (as defined in the Amended Credit Facility) of no less than 2.5 to 1.0 for the four quarters ended on the last day of each quarter. This covenant replaces the Total Net Debt (as defined in the Amended Credit Facility) to consolidated EBITDAX ratio covenant described in Note 7 above. All other significant rates, terms and conditions of the Amended Credit Facility remained the same (see Note 7 Long-Term Debt).

Derivative instruments. In October 2012, the Company entered into new two-way and three-way costless collar options, all of which settle monthly based on the West Texas Intermediate crude oil index price, for a total notional amount of 668,000 barrels in 2013, 396,000 barrels in 2014 and 31,000 barrels in 2015. These derivative instruments do not qualify for and were not designated as hedging instruments for accounting purposes.

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Item 2. Management s Discussion and Analysis of Financial Condition and Results of Operations

The following discussion and analysis of our financial condition and results of operations should be read in conjunction with Management s Discussion and Analysis of Financial Condition and Results of Operations contained in our Annual Report on Form 10-K for the year ended December 31, 2011 (2011 Annual Report), as well as the unaudited condensed consolidated financial statements and notes thereto included in this Quarterly Report on Form 10-Q.

CAUTIONARY NOTE REGARDING FORWARD-LOOKING STATEMENTS

This Quarterly Report on Form 10-Q contains forward-looking statements within the meaning of Section 27A of the Securities Act of 1933, as amended, and Section 21E of the Securities and Exchange Act of 1934, as amended. These forward-looking statements are subject to a number of risks and uncertainties, many of which are beyond our control. All statements, other than statements of historical fact included in this Quarterly Report on Form 10-Q, regarding our strategy, future operations, financial position, estimated revenues and losses, projected costs, prospects, plans and objectives of management are forward-looking statements. When used in this Quarterly Report on Form 10-Q, the words could, believe, anticipate, intend, estimate, expect, may, continue, predict, potential, project and similar expressions are in forward-looking statements, although not all forward-looking statements contain such identifying words. In particular, the factors discussed below and detailed under Item 1A. Risk Factors in our 2011 Annual Report and in our Quarterly Report on Form 10-Q for the quarterly period ended March 31, 2012 could affect our actual results and cause our actual results to differ materially from expectations, estimates, or assumptions expressed in, forecasted in, or implied in such forward-looking statements.

Forward-looking statements may include statements about:

- our business strategy;
- estimated future net reserves and present value thereof;
- technology;
- cash flows and liquidity;
- our financial strategy, budget, projections, execution of business plan and operating results;
- oil and natural gas realized prices;
- timing and amount of future production of oil and natural gas;
- availability of drilling, completion and production equipment and materials;
- availability of qualified personnel;
- owning and operating a services company;

the amount, nature and timing of capital expenditures;

availability and terms of capital;

property acquisitions;

costs of exploiting and developing our properties and conducting other operations;

drilling and completion of wells;

infrastructure for salt water disposal;

gathering, transportation and marketing of oil and natural gas, both in the Williston Basin and domestically;

general economic conditions;

operating environment, including inclement weather conditions;

competition in the oil and natural gas industry;

effectiveness of risk management activities;

environmental liabilities;

counterparty credit risk;

governmental regulation and the taxation of the oil and natural gas industry;

- developments in oil-producing and natural gas-producing countries;
- uncertainty regarding future operating results; and
- plans, objectives, expectations and intentions contained in this report that are not historical.

All forward-looking statements speak only as of the date of this Quarterly Report on Form 10-Q. We disclaim any obligation to update or revise these statements unless required by securities law, and you should not place undue reliance on these forward-looking statements. Although we believe that our plans, intentions and expectations reflected in or suggested by the forward-looking statements we make in this Quarterly Report on Form 10-Q are reasonable, we can give no assurance that these plans, intentions or expectations will be achieved. Some of the key factors which could cause actual results to vary from our expectations include changes in oil and natural gas prices, the timing of planned capital expenditures, availability of acquisitions, uncertainties in estimating proved reserves and forecasting production results, operational factors affecting the commencement or maintenance of producing wells, the condition of the capital markets generally, as well as our ability to access them, the proximity to and capacity of transportation facilities, and uncertainties regarding environmental regulations or litigation and other legal or regulatory developments affecting our business, as well as those factors discussed below and elsewhere in this Quarterly Report on Form 10-Q, all of which are difficult to predict. In light of these risks, uncertainties and assumptions, the forward-looking events discussed may not occur. These cautionary statements qualify all forward-looking statements attributable to us or persons acting on our behalf.

Overview

We are an independent exploration and production company focused on the acquisition and development of unconventional oil and natural gas resources primarily in the Montana and North Dakota regions of the Williston Basin. Since our inception, we have acquired properties that provide current production and significant upside potential through further development. Our drilling activity is primarily directed toward projects that we believe can provide us with repeatable successes in the Bakken and Three Forks formations. We also operate businesses that are complementary to our primary development and production activities, including a marketing business, Oasis Petroleum Marketing LLC (OPM), and a well services business, Oasis Well Services LLC (OWS). The revenues and expenses related to work performed by OPM and OWS for Oasis Petroleum North America LLC s working interests are eliminated in consolidation and, therefore, do not directly contribute to our consolidated results of operations.

Our use of capital for acquisitions and development allows us to direct our capital resources to what we believe to be the most attractive opportunities as market conditions evolve. We have historically acquired properties that we believe will meet or exceed our rate of return criteria. For acquisitions of properties with additional development, exploitation and exploration potential, we have focused on acquiring properties that we expect to operate so that we can control the timing and implementation of capital spending. In some instances, we have acquired non-operated property interests at what we believe to be attractive rates of return either because they provided a foothold in a new area of interest or complemented our existing operations. We intend to continue to acquire both operated and non-operated properties to the extent we believe they meet our return objectives. In addition, the acquisition of non-operated properties in new areas provides us with geophysical and geologic data that may lead to further acquisitions in the same area, whether on an operated or non-operated basis.

Due to the geographic concentration of our oil and natural gas properties in the Williston Basin, we believe the primary sources of opportunities, challenges and risks related to our business for both the short and long-term are:

- Commodity prices for oil and natural gas;
- Transportation capacity;
- Availability and cost of services; and
- Availability of qualified personnel.

Our revenue, profitability and future growth rate depend substantially on factors beyond our control, such as economic, political and regulatory developments as well as competition from other sources of energy. Oil and natural gas prices historically have been volatile and may fluctuate widely in the future. Sustained periods of low prices for oil or natural gas could materially and adversely affect our financial position, our results of operations, the quantities of oil and natural gas reserves that we can economically produce and our access to capital.

Prices for oil and natural gas can fluctuate widely in response to relatively minor changes in the global and regional supply of and demand for oil and natural gas, as well as market uncertainty, economic conditions and a variety of additional factors. Since the inception of our oil and natural gas activities, commodity prices have experienced significant fluctuations. We enter into crude oil sales contracts with purchasers who have access to crude oil transportation capacity, utilize derivative financial instruments to manage our commodity price risk, and enter into physical delivery contracts to manage our price differentials. In an effort to improve price realizations from the sale of our oil and natural gas, we manage our commodities marketing activities in-house, which enables us to market and sell our oil and natural gas to a broader array of potential purchasers. Due to the availability of other markets and pipeline connections, we do not believe that the loss of any single oil or natural gas customer would have a material adverse effect on our results of operations or cash flows. Additionally, during the first three quarters of 2012, we began to actively increase the number of operated wells that we have connected to a third-party oil gathering system in our West Williston project area. At the end of September 2012, the Company had 108 operated wells connected, up from only three operated wells that were connected at the beginning of 2012. We currently flow approximately 60% of our gross operated oil production on the third-party oil gathering system. This same third-party has also agreed to extend the system into our East Nesson project area in 2013, which we expect will increase the gross operated oil production that will flow on the system to over 80% by mid-year 2013.

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Changes in commodity prices may also significantly affect the economic viability of drilling projects as well as the economic valuation and economic recovery of oil and gas reserves. Oil prices have increased significantly since 2009. As a result of higher commodity prices and continued successes in the application of completion technologies in the Bakken formation, there were approximately 220 active drilling rigs in the Williston Basin at September 30, 2012. Both takeaway capacity and production have rapidly grown in the Williston Basin throughout 2012. In the first half of 2012, price differentials were at or above the historical average discount range of 10% to 15% to the price quoted for NYMEX West Texas Intermediate (WTI) crude oil due to production growth in the Williston Basin combined with refinery and transportation constraints. In the third quarter of 2012, differentials began to narrow, primarily due to transportation capacity additions outpacing production growth.

Our large concentrated acreage position potentially provides us with a multi-year inventory of drilling projects and requires some forward planning visibility for obtaining services. Our ability to develop and hold our existing undeveloped leasehold acreage is primarily dependent upon having access to drilling rigs and completion services. The utilization of existing drilling rigs and of existing completion service equipment in the Williston Basin is at an all-time high. This has resulted in drilling rigs, completion equipment and crews being imported from Canada and other parts of the United States. To ensure access to drilling rigs, we have entered into fixed-term drilling rig contracts for periods of up to three years and currently have nine drilling rigs under contract. In order to ensure the availability of completion services and the timely fracture stimulation of newly drilled wells, we formed OWS in June 2011 to provide well services on our operated wells, in addition to entering into fracturing service contracts with third party companies.

Third Quarter 2012 Highlights:

On July 2, 2012, we issued $400 million of 6.875% senior unsecured notes due January 15, 2023, resulting in net proceeds to us of approximately $392 million;

We completed and placed on production 34 gross operated wells in the Williston Basin during the three months ended September 30, 2012;

We had 25 gross operated wells awaiting completion and 11 gross operated wells in the process of being drilled in the Bakken and Three Forks formations at September 30, 2012;

Average daily production was 24,257 Boe per day during the three months ended September 30, 2012;

Exploration and production (E&P) capital expenditures were $311.4 million, consisting primarily of $275.9 million in drilling expenditures during the three months ended September 30, 2012; and

At September 30, 2012, we had $406.5 million of cash and cash equivalents and short-term investments and had no borrowings or outstanding letters of credit under our revolving credit facility.

Results of Operations

Revenues

Our revenues are derived from the sale of oil and natural gas production and do not include the effects of derivative instruments. Our revenues may vary significantly from period to period as a result of changes in volumes of production sold or changes in commodity prices.

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The following table summarizes our revenues and production data for the periods indicated.

	Three Months Ended September 30,			Nine Months Ended September 30,		
	2012	2011	Change	2012	2011	Change
Operating results (in thousands):						
Revenues						
Oil	$ 173,752	$ 85,870	$ 87,882	$ 443,686	$ 208,442	$ 235,244
Natural gas	4,996	1,726	3,270	18,171	5,104	13,067
Well services	5,963		5,963	10,484		10,484
Total revenues	184,711	87,596	97,115	472,341	213,546	258,795

Production data:	2013	% Change	2012	% Change	2011
	(in thousands, except percentage data)				
Net revenue	$311,261	1.1 %	$307,945	(7.1)%	$ 331,439
Percentage of net revenue	22.7 %		24.2 %		28.1 %
Contribution income	66,506	(1.9)%	67,826	(9.3)%	74,746
Contribution margin	21.4 %		22.0 %		22.6 %

2013 vs 2012

Net revenue in the commercial business unit increased $3.3 million, or 1.1%, to $311.3 million for the year ended December 31, 2013, from $307.9 million for the year ended December 31, 2012. The increase is primarily attributable to increased sales of our switches, partially offset by a decrease in sales of our wireless products. Contribution income decreased $1.3 million, or 1.9%, to $66.5 million for the year ended December 31, 2013, from $67.8 million for the year ended December 31, 2012. The decrease was primarily attributable to increased cost of revenues driven by increased freight and warranty costs. The decrease in contribution income as a result of the increase in cost of revenues was partially offset by a benefit from decreased sales and marketing and research and development costs.

2012 vs 2011

The commercial business unit experienced a decrease in net revenue from 2011 to 2012. The decrease was primarily experienced in the EMEA region, as the region continued to experience macroeconomic weakness in the European market. Net revenues from sales in the Americas and APAC regions remained relatively flat. On a product-level, the decrease was primarily attributable to a decrease in sales from our network storage product line. Contribution income also decreased, primarily due to the decline in revenue out-pacing the savings from decreases in our costs of revenue and operating expenses. Net revenue decreased by 7.1%, while costs of revenue and operating expenses decreased by 6.5% and 6.3% respectively. The decrease in costs of revenue was primarily attributable to the decrease in net revenues and a more favorable air/sea freight mix. The decrease in our commercial business unit's operating expenses was primarily due to a decrease in sales and marketing cost, partially offset by an increase in research and development costs.

Service Provider

	Year Ended December 31,				
	2013	% Change	2012	% Change	2011
	(in thousands, except percentage data)				
Net revenue	$548,448	19.4 %	$459,179	24.9 %	$367,784
Percentage of net revenue	40.0 %		36.1 %		31.1 %
Contribution income	51,620	26.5 %	40,794	24.4 %	32,797
Contribution margin	9.4 %		8.9 %		8.9 %

2013 vs 2012

Net revenue in the service provider business unit increased $89.3 million, to $548.4 million for the year ended December 31, 2013, from $459.2 million for the year ended December 31, 2012. The increase is primarily attributed to increased sales of our mobile products as a result of the AirCard acquisition and home security monitoring and automation products, partially offset by a decrease in sales of our broadband gateways. The decrease in sales of our broadband gateways is partially due to the consolidation among cable operators in Europe in the second half of 2013. Contribution income increased $10.8 million, or 26.5%, to $51.6 million for the year ended December 31, 2013, from $40.8 million for the year ended December 31, 2012. The increase is primarily due to an increase in gross profit, largely attributable to revenue growth, partially offset by an increase in excess and obsolete inventory charges and increased research and development costs.

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2012 vs 2011

The service provider business unit experienced strong net revenue growth from 2011 to 2012. The increase was primarily attributable to sales growth of our broadband gateway products, primarily driven by service provider demand for our Docsis 3.0 products, and to a lesser extent, the acquisition of the Customer Networking Solutions division of Westell Technologies, Inc. Contribution income remained in line with revenue growth, with net revenue increasing by 24.9%, while costs of revenue and operating expenses increased by 25.2% and 22.3% respectively. The increase in costs of revenue was primarily due to revenue growth and the increase in operating expenses was primarily attributable to increased investments in research and development.

Liquidity and Capital Resources

As of December 31, 2013, we had cash, cash equivalents and short-term investments totaling $248.2 million.

Our cash and cash equivalents balance decreased from $149.0 million as of December 31, 2012 to $143.0 million as of December 31, 2013. Our short-term investments, which represent the investment of funds available for current operations, decreased from $227.8 million as of December 31, 2012 to $105.1 million as of December 31, 2013. The decrease in cash and cash equivalents and short-term investments are mainly attributable to the AirCard and Arada acquisitions in the second quarter of 2013 and repurchase of shares in the fourth quarter of 2013. Operating activities during the year ended December 31, 2013, generated cash of $86.9 million. Investing activities during the year ended December 31, 2013 used $39.7 million, mainly due to the payments made in connection with business acquisitions of $147.2 million, primarily related to the AirCard acquisition, and purchases of property and equipment of $18.1 million, offset by net proceeds of $121.9 million from maturities of short-term investments. During the year ended December 31, 2013, financing activities used $53.2 million, primarily due to the repurchase of common stock, partially offset by the issuance of our common stock upon exercise of stock options and our employee stock purchase program, as well as the excess tax benefit from exercises and cancellations of stock options.

Our days sales outstanding as of December 31, 2013 was 69 days, a decrease from 76 days as of December 31, 2012, as a result of our continuous efforts to manage collections.

Our accounts payable increased from $87.3 million at December 31, 2012 to $114.5 million at December 31, 2013, primarily as a result of timing of payments.

Inventory increased from $174.9 million at December 31, 2012 to $224.5 million at December 31, 2013. Ending inventory turns decreased to 4.6 turns in the three months ended December 31, 2013, from 5.0 turns in the three months ended December 31, 2012.

We enter into foreign currency forward-exchange contracts, which typically mature in three to five months, to hedge a portion of our exposure to foreign currency fluctuations of foreign currency-denominated revenue, costs of revenue, certain operating expenses, receivables, payables, and cash balances. We record on the consolidated balance sheet at each reporting period the fair value of our forward-exchange contracts and record any fair value adjustments in our Consolidated Statements of Operations and in our Consolidated Balance Sheets. Gains and losses associated with currency rate changes on hedge contracts that are non-designated under the authoritative guidance for derivatives and hedging are recorded within other income (expense), net, offsetting foreign exchange gains and losses on our monetary assets and liabilities. Gains and losses associated with currency rate changes on hedge contracts that are designated cash flow hedges under the authoritative guidance for derivatives and hedging are recorded within cumulative other comprehensive income until the related revenue, costs of revenue, or expenses are recognized.

On June 21, 2013, we acquired certain assets and operations of Arada, a privately-held company that develops, licenses, and provides solutions for the next generation of uses of Wi-Fi, for total purchase consideration of $5.3 million in cash. We believe the acquisition will bolster our wireless product offerings in our commercial business unit and strengthen our market position in the small to medium size campus wireless LAN market.

On April 2, 2013, we paid $140.0 million of the aggregate purchase price and completed the acquisition of select assets and operations of the Sierra Wireless, Inc. AirCard business, including several customer relationships, a world-class LTE engineering team, certain intellectual property, inventory and fixed assets. We believe this acquisition will accelerate the mobile initiative of the service provider business unit to become a global leader in providing the latest in LTE data networking access devices.

On October 21, 2008, the Board of Directors authorized management to repurchase up to 6.0 million shares of our outstanding common stock. Under this authorization, the timing and actual number of shares subject to repurchase are at the discretion of management and are contingent on a number of factors, such as levels of cash generation from operations, cash requirements for

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acquisitions and the price of our common stock. During the year ended December 31, 2013, we repurchased and retired 2.0 million shares or $63.1 million of common stock under this authorization and we did not repurchase any shares during the years ended December 31, 2012 or 2011.

We also repurchased approximately 14,000 shares, or $0.5 million of common stock under a repurchase program to help administratively facilitate the withholding and subsequent remittance of personal income and payroll taxes for individuals receiving RSUs during the year ended December 31, 2013. Similarly, during the years ended December 31, 2012 and December 31, 2011, we repurchased approximately 22,000 shares and 25,000 shares, respectively, or $0.9 million and $0.9 million of common stock, respectively, under the same program to help facilitate tax withholding for RSUs. These shares were retired upon repurchase.

Based on our current plans and market conditions, we believe that our existing cash, cash equivalents and short-term investments will be sufficient to satisfy our anticipated cash requirements for the foreseeable future. However, we cannot be certain that our planned levels of revenue, costs and expenses will be achieved. If our operating results fail to meet our expectations or if we fail to manage our inventory, accounts receivable or other assets, we could be required to seek additional funding through public or private financings or other arrangements. In addition, as we continue to expand our product offerings, channels and geographic presence, we may require additional working capital. In such event, adequate funds may not be available when needed or may not be available on favorable or commercially acceptable terms, which could have a negative effect on our business and results of operations.

Backlog

As of December 31, 2013, we had a backlog of approximately $139.4 million, compared to approximately $104.6 million as of December 31, 2012, primarily due to product demand required in the future. Our backlog consists of products for which customer purchase orders have been received and that are scheduled or in the process of being scheduled for shipment. While we expect to fulfill the order backlog within the current year, most orders are subject to rescheduling or cancellation with little or no penalties. Because of the possibility of customer changes in product scheduling or order cancellation, our backlog as of any particular date may not be an indicator of net sales for any succeeding period.

Contractual Obligations and Off-Balance Sheet Arrangements

Contractual Obligations

The following table describes our commitments to settle non-cancelable lease and purchase commitments as of December 31, 2013 (in thousands).

	Less Than 1 Year	1-3 Years	3-5 Years	More Than 5 Years	Total
Operating leases	$2,987	$15,248	$9,726	$5,988	$33,949
Purchase obligations	187,348	—	—	—	187,348
	$190,335	$15,248	$9,726	$5,988	$221,297

We lease office space, cars and equipment under non-cancelable operating leases with various expiration dates through December 2026. Rent expense in the years ended December 31, 2013, 2012, and 2011 was $9.9 million, $7.6 million and $7.0 million, respectively. The terms of some of the office leases provide for rental payments on a graduated scale. We recognize rent expense on a straight-line basis over the lease period, and have accrued for rent expense incurred but not paid. The amounts presented are consistent with contractual terms and are not expected to differ significantly, unless a substantial change in our headcount needs requires us to exit an office facility early or expand our occupied space.

We enter into various inventory-related purchase agreements with suppliers. Generally, under these agreements, 50% of the orders are cancelable by giving notice 46 to 60 days prior to the expected shipment date and 25% of orders are cancelable by giving notice 31 to 45 days prior to the expected shipment date. Orders are not cancelable within 30 days prior to the expected shipment date. At December 31, 2013, we had $187.3 million in non-cancelable purchase commitments with suppliers. We expect to sell all products for which we have committed purchases from suppliers.

As of December 31, 2013 and December 31, 2012, we had $14.6 million and $13.8 million, respectively, of total gross unrecognized tax benefits and related interest. The timing of any payments that could result from these unrecognized tax benefits will depend upon a number of factors. The unrecognized tax benefits have been excluded from the contractual obligations table

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because reasonable estimates cannot be made of whether, or when, any cash payments for such items might occur. The possible reduction in liabilities for uncertain tax positions in multiple jurisdictions that may impact the statement of operations in the next 12 months is approximately $2.8 million, excluding the interest, penalties and the effect of any related deferred tax assets or liabilities.

Off-Balance Sheet Arrangements

As of December 31, 2013, we did not have any off-balance sheet arrangements as defined in Item 303(a)(4)(ii) of Regulation S-K.

Recent Accounting Pronouncements

See Note 1, The Company and Summary of Significant Accounting Policies, in Notes to Consolidated Financial Statements in Item 8 of Part II of this Annual Report on Form 10-K, for a full description of recent accounting pronouncements, including the expected dates of adoption and estimated effects on financial condition and results of operations, which are hereby incorporated by reference.

Item 7A. Quantitative and Qualitative Disclosures About Market Risk

Interest Rate Risk

We do not use derivative financial instruments in our investment portfolio. We have an investment portfolio of fixed income securities that are classified as “available-for-sale” securities. These securities, like all fixed income instruments, are subject to interest rate risk and will fall in value if market interest rates increase. We attempt to limit this exposure by investing primarily in highly rated short-term securities. Our investment policy requires investments to be rated triple-A with the objective of minimizing the potential risk of principal loss. Due to the short duration and conservative nature of our investment portfolio, a movement of 10% by market interest rates would not have a material impact on our operating results and the total value of the portfolio over the next fiscal year. We monitor our interest rate and credit risks, including our credit exposure to specific rating categories and to individual issuers. There were no impairment charges on our investments during fiscal 2013.

Foreign Currency Transaction Risk

We invoice some of our international customers in foreign currencies including, but not limited to, the Australian dollar, British pound, euro, and Japanese yen. As the customers that are currently invoiced in local currency become a larger percentage of our business, or to the extent we begin to bill additional customers in foreign currencies, the impact of fluctuations in foreign exchange rates could have a more significant impact on our results of operations. For those customers in our international markets that we continue to sell to in U.S. dollars, an increase in the value of the U.S. dollar relative to foreign currencies could make our products more expensive and therefore reduce the demand for our products. Such a decline in the demand for our products could reduce sales and negatively impact our operating results. Certain operating expenses of our foreign operations require payment in the local currencies.

We are exposed to risks associated with foreign exchange rate fluctuations due to our international sales and operating activities. These exposures may change over time as business practices evolve and could negatively impact our operating results and financial condition. We began using foreign currency forward contract derivatives in the fourth quarter of 2008 to partially offset our business exposure to foreign exchange risk on our foreign currency denominated assets and liabilities. Additionally, in the second quarter of 2009 we began entering into certain foreign currency forward contracts that have been designated as cash flow hedges under the authoritative guidance for derivatives and hedging to partially offset our business exposure to foreign exchange risk on portions of our anticipated foreign currency revenue, costs of revenue, and certain operating expenses. The objective of these foreign currency forward contracts is to reduce the impact of currency exchange rate movements on our operating results by offsetting gains and losses on the forward contracts with increases or decreases in foreign currency transactions. The contracts are marked-to-market on a monthly basis with gains and losses included in other income (expense), net in the Consolidated Statements of Operations, and in cumulative other comprehensive income on the Consolidated Balance Sheets. We do not use foreign currency contracts for speculative or trading purposes. Hedging of our balance sheet and anticipated cash flow exposures may not always be effective to protect us against currency exchange rate fluctuations. In addition, we do not fully hedge our balance sheet and anticipated cash flow exposures, leaving us at risk to foreign exchange gains and losses on the un-hedged exposures. If there were an adverse movement in exchange rates, we might suffer significant losses. See Note 5, Derivative Financial Instruments, of the Notes to Consolidated Financial Statements for additional disclosure on our foreign currency contracts, which are hereby incorporated by reference into this Part II, Item 7A.

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As of December 31, 2013, we had net assets in various local currencies. A hypothetical 10% movement in foreign exchange rates would result in an after-tax positive or negative impact of $279,000 to net income, net of our hedged position, at December 31, 2013. Actual future gains and losses associated with our foreign currency exposures and positions may differ materially from the sensitivity analyses performed as of December 31, 2013 due to the inherent limitations associated with predicting the foreign currency exchange rates, and our actual exposures and positions. For the year ended December 31, 2013, 12% of total net revenue was denominated in a currency other than the U.S. dollar.

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Item 8. Financial Statements and Supplementary Data

Report of Independent Registered Public Accounting Firm

To the Board of Directors and Stockholders of NETGEAR, Inc.:

In our opinion, the consolidated financial statements listed in the index appearing under Item 15(a) (1) present fairly, in all material respects, the financial position of NETGEAR, Inc. and its subsidiaries at December 31, 2013 and December 31, 2012, and the results of their operations and their cash flows for each of the three years in the period ended December 31, 2013 in conformity with accounting principles generally accepted in the United States of America. In addition, in our opinion, the financial statement schedule listed in the index appearing under Item 15(a)(2) presents fairly, in all material respects, the information set forth therein when read in conjunction with the related consolidated financial statements. Also in our opinion, the Company maintained, in all material respects, effective internal control over financial reporting as of December 31, 2013, based on criteria established in Internal Control - Integrated Framework (1992) issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO). The Company's management is responsible for these financial statements and financial statement schedule, for maintaining effective internal control over financial reporting and for its assessment of the effectiveness of internal control over financial reporting, included in Management's Report on Internal Control over Financial Reporting under Item 9A. Our responsibility is to express opinions on these financial statements, on the financial statement schedule, and on the Company's internal control over financial reporting based on our integrated audits. We conducted our audits in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audits to obtain reasonable assurance about whether the financial statements are free of material misstatement and whether effective internal control over financial reporting was maintained in all material respects. Our audits of the financial statements included examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, and evaluating the overall financial statement presentation. Our audit of internal control over financial reporting included obtaining an understanding of internal control over financial reporting, assessing the risk that a material weakness exists, and testing and evaluating the design and operating effectiveness of internal control based on the assessed risk. Our audits also included performing such other procedures as we considered necessary in the circumstances. We believe that our audits provide a reasonable basis for our opinions.

A company's internal control over financial reporting is a process designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles. A company's internal control over financial reporting includes those policies and procedures that (i) pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the company; (ii) provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with generally accepted accounting principles, and that receipts and expenditures of the company are being made only in accordance with authorizations of management and directors of the company; and (iii) provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use, or disposition of the company's assets that could have a material effect on the financial statements.

Because of its inherent limitations, internal control over financial reporting may not prevent or detect misstatements. Also, projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

/s/ PricewaterhouseCoopers LLP
San Jose, CA
February 25, 2014

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NETGEAR, INC.
CONSOLIDATED BALANCE SHEETS
(In thousands, except share and per share data)

	December 31, 2013	December 31, 2012
ASSETS		
Current assets:		
Cash and cash equivalents	$143,009	$149,032
Short-term investments	105,145	227,845
Accounts receivable, net	266,484	256,014
Inventories	224,456	174,903
Deferred income taxes	27,239	22,691
Prepaid expenses and other current assets	33,778	33,724
Total current assets	800,111	864,209
Property and equipment, net	27,194	19,025
Intangibles, net	84,118	27,621
Goodwill	155,916	100,880
Other non-current assets	26,591	22,834
Total assets	$1,093,930	$1,034,569
LIABILITIES AND STOCKHOLDERS' EQUITY		
Current liabilities:		
Accounts payable	$114,531	$87,310
Accrued employee compensation	16,551	18,338
Other accrued liabilities	143,218	126,255
Deferred revenue	24,496	27,645
Income taxes payable	1,287	1,382
Total current liabilities	300,083	260,930
Non-current income taxes payable	13,804	13,735
Other non-current liabilities	6,260	5,293
Total liabilities	320,147	279,958
Commitments and contingencies (Note 9)		
Stockholders' equity:		
Preferred stock: $0.001 par value; 5,000,000 shares authorized; none issued or outstanding	—	—
Common stock: $0.001 par value; 200,000,000 shares authorized; shared issued and outstanding: 36,839,522 and 38,341,644 at December 31, 2013 and 2012, respectively	37	38
Additional paid-in capital	421,901	394,427
Cumulative other comprehensive income	69	4
Retained earnings	351,776	360,142
Total stockholders' equity	773,783	754,611
Total liabilities and stockholders' equity	$1,093,930	$1,034,569

The accompanying notes are an integral part of these consolidated financial statements.

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NETGEAR, INC.

CONSOLIDATED STATEMENTS OF OPERATIONS
(In thousands, except per share data)

	Year Ended December 31,		
	2013	2012	2011
Net revenue	$1,369,633	$1,271,921	$1,181,018
Cost of revenue	976,018	888,368	811,572
Gross profit	393,615	383,553	369,446
Operating expenses:			
Research and development	85,168	61,066	48,699
Sales and marketing	153,804	149,766	154,562
General and administrative	48,915	45,027	39,423
Restructuring and other charges	5,335	1,190	2,094
Litigation reserves, net	5,354	390	(201)
Impairment charges	2,000	—	—
Total operating expenses	300,576	257,439	244,577
Income from operations	93,039	126,114	124,869
Interest income	400	498	477
Other (expense) income, net	(457)	2,670	(1,136)
Income before income taxes	92,982	129,282	124,210
Provision for income taxes	37,765	42,743	32,842
Net income	$55,217	$86,539	$91,368
Net income per share:			
Basic	$1.44	$2.27	$2.46
Diluted	$1.42	$2.23	$2.41
Weighted average shares outstanding used to compute net income per share:			
Basic	38,379	38,057	37,121
Diluted	38,948	38,747	37,932

The accompanying notes are an integral part of these consolidated financial statements.

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NETGEAR, INC.
CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME
(In thousands)

	Year Ended December 31,		
	2013	2012	2011
Net income	$55,217	$86,539	$91,368
Other comprehensive income (loss), before tax:			
Unrealized gain (loss) on derivative instruments	89	(30)	(267)
Unrealized (loss) gain on available-for-sale securities	(40)	16	17
Other comprehensive income (loss), before tax	49	(14)	(250)
Tax benefit (expense) related to items of other comprehensive income	16	(5)	(8)
Other comprehensive income (loss), net of tax	65	(19)	(258)
Comprehensive income	$55,282	$86,520	$91,110

The accompanying notes are an integral part of these consolidated financial statements.

NETGEAR, INC.

CONSOLIDATED STATEMENTS OF STOCKHOLDERS' EQUITY
(In thousands)

	Common Stock					
	Shares	Amount	Additional Paid-In Capital	Cumulative Other Comprehensive Income (Loss)	Retained Earnings	Total
Balance at December 31, 2010	36,173	$36	$316,108	$ 281	$184,011	$500,436
Change in unrealized gains and losses on available-for-sale securities, net of tax	—	—	—	9	—	9
Change in unrealized gains and losses on derivatives, net of tax	—	—	—	(267)	—	(267)
Net income	—	—	—	—	91,368	91,368
Stock-based compensation expense	—	—	13,727	—	—	13,727
Purchase and retirement of common stock	(25)	—	—	—	(926)	(926)
Issuance of common stock under stock-based compensation plans	1,499	2	30,889	—	—	30,891
Tax benefit from exercises and cancellations of stock options	—	—	3,519	—	—	3,519
Balance at December 31, 2011	37,647	38	364,243	23	274,453	638,757
Change in unrealized gains and losses on available-for-sale securities, net of tax	—	—	—	11	—	11
Change in unrealized gains and losses on derivatives, net of tax	—	—	—	(30)	—	(30)
Net income	—	—	—	—	86,539	86,539
Stock-based compensation expense	—	—	14,366	—	—	14,366
Purchase and retirement of common stock	(22)	—	—	—	(850)	(850)
Issuance of common stock under stock-based compensation plans	717	—	14,697	—	—	14,697
Tax benefit from exercises and	—	—	1,121	—	—	1,121

cancellations of stock options						
Balance at December 31, 2012	38,342	38	394,427	4	360,142	754,611
Change in unrealized gains and losses on available-for-sale securities, net of tax	—	—	—	(24)	—	(24)
Change in unrealized gains and losses on derivatives, net of tax	—	—	—	89	—	89
Net income	—	—	—	—	55,217	55,217
Stock-based compensation expense	—	—	17,419	—	—	17,419
Purchase and retirement of common stock	(2,018)	(1)	—	—	(63,583)	(63,584)
Issuance of common stock under stock-based compensation plans	516	—	9,626	—	—	9,626
Tax benefit from exercises and cancellations of stock options	—	—	429	—	—	429
Balance at December 31, 2013	36,840	$37	$421,901	$ 69	$351,776	$773,783

The accompanying notes are an integral part of these consolidated financial statements.

NETGEAR, INC.

CONSOLIDATED STATEMENTS OF CASH FLOWS
(In thousands)

	Year Ended December 31,		
	2013	2012	2011
Cash flows from operating activities:			
Net income	$55,217	$86,539	$91,368
Adjustments to reconcile net income to net cash provided by operating activities:			
Depreciation and amortization	32,854	16,775	14,735
Purchase premium amortization/discount accretion on investments, net	1,103	2,490	986
Non-cash stock-based compensation	17,462	14,372	13,762
Income tax benefit associated with stock option exercises	428	1,121	3,519
Gain on sale of cost method investment	—	(3,126)	—
Excess tax benefit from stock-based compensation	(767)	(1,552)	(3,672)
Impairment charges	2,000	—	—
Deferred income taxes	(7,927)	(2,545)	(4,621)
Changes in assets and liabilities, net of effect of acquisitions:			
Accounts receivable	(10,470)	5,317	(34,576)
Inventories	(46,679)	(10,590)	(30,039)
Prepaid expenses and other assets	(4,615)	2,619	(7,935)
Accounts payable	36,250	(30,615)	28,131
Accrued employee compensation	(1,787)	(8,782)	2,765
Other accrued liabilities	15,070	3,444	9,374
Deferred revenue	(1,211)	(12,680)	12,555
Income taxes payable	(26)	(7,744)	(342)
Net cash provided by operating activities	86,902	55,043	96,010
Cash flows from investing activities:			
Purchases of short-term investments	(153,464)	(369,939)	(228,871)
Proceeds from maturities of short-term investments	275,406	284,418	227,669
Purchase of property and equipment	(18,050)	(14,762)	(8,211)
Payments for patents	(275)	(1,400)	—
Cost method investments	3,890	—	—
Payments made in connection with business acquisitions, net of cash acquired	(147,240)	(28,625)	(37,509)
Net cash used in investing activities	(39,733)	(130,308)	(46,922)
Cash flows from financing activities:			
Purchase and retirement of common stock	(63,585)	(850)	(926)
Proceeds from exercise of stock options	7,487	12,700	29,139
Proceeds from issuance of common stock under employee stock purchase plan	2,139	1,997	1,752
Excess tax benefit from stock-based compensation	767	1,552	3,672
Net cash (used) provided by financing activities	(53,192)	15,399	33,637
Net (decrease) increase in cash and cash equivalents	(6,023)	(59,866)	82,725
Cash and cash equivalents, at beginning of period	149,032	208,898	126,173
Cash and cash equivalents, at end of period	$143,009	$149,032	$208,898
Supplemental Cash Flow Information:			
Cash paid for income taxes	$45,982	$52,403	$34,365

The accompanying notes are an integral part of these consolidated financial statements.

NETGEAR, INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

Note 1. The Company and Summary of Significant Accounting Policies

The Company

NETGEAR, Inc. (“NETGEAR” or the “Company”) was incorporated in Delaware in January 1996. The Company is a global networking company that delivers innovative products to consumers, businesses and service providers. The Company's products are built on a variety of proven technologies such as wireless, Ethernet and powerline, with a focus on reliability and ease-of-use. The product line consists of wired and wireless devices that enable networking, broadband access and network connectivity. These products are available in multiple configurations to address the needs of the end-users in each geographic region in which the Company's products are sold.

The Company operates in three specific business segments: retail, commercial, and service provider. Each business unit is managed by a Senior Vice President/General Manager. The Company believes this structure enables it to better focus its efforts on the Company's core customer segments and allows it to be more nimble and opportunistic as a company overall. The retail business unit is focused on individual consumers and consists of high performance, dependable and easy-to-use home networking, home video monitoring, storage and digital media products. The commercial business unit is focused on small and medium size businesses and consists of business networking, storage and security solutions that bring enterprise class functionality at an affordable price. The service provider business unit is focused on the service provider market and consists of made-to-order and retail proven, whole home networking hardware and software solutions, as well as 4G LTE hotspots sold to service providers for sale to their subscribers.

The Company sells networking products through multiple sales channels worldwide, including traditional retailers, online retailers, wholesale distributors, direct market resellers (“DMRs”), value-added resellers (“VARs”), and broadband service providers.

Basis of presentation

The accompanying consolidated financial statements include the accounts of the Company and its wholly owned subsidiaries. All inter-company accounts and transactions have been eliminated in the consolidation of these subsidiaries.

Fiscal periods

The Company's fiscal year begins on January 1 of the year stated and ends on December 31 of the same year. The Company reports its results on a fiscal quarter basis rather than on a calendar quarter basis. Under the fiscal quarter basis, each of the first three fiscal quarters ends on the Sunday closest to the calendar quarter end, with the fourth quarter ending on December 31.

Use of estimates

The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reported period. Actual results could differ from those estimates.

Cash and cash equivalents

The Company considers all highly liquid investments with an original maturity at the time of purchase of three months or less to be cash equivalents. The Company deposits cash and cash equivalents with high credit quality financial institutions.

Short-term investments

Short-term investments are partially comprised of marketable securities that consist of government securities with an original maturity or a remaining maturity at the time of purchase, of greater than three months and no more than 12 months. The marketable securities are held in the Company's name with one high quality financial institution, which acts as the Company's custodian and investment manager. These marketable securities are classified as available-for-sale securities in accordance with the provisions of the authoritative guidance for investments and are carried at fair value with unrealized gains and losses reported as a separate component of stockholders' equity.

Short-term investments are also comprised of marketable securities related to deferred compensation under the Company's Deferred Compensation Plan. Mutual funds are the only investments allowed in the Company's Deferred Compensation Plan and the investments are held in a grantor trust formed by the Company. The Company has classified these investments as trading securities as the grantor trust actively manages the asset allocation to match the participants' notional fund allocations. These securities are recorded at fair market value with unrealized gains and losses included in other income (expense), net.

Certain risks and uncertainties

The Company's products are concentrated in the networking industry, which is characterized by rapid technological advances, changes in customer requirements and evolving regulatory requirements and industry standards. The success of the Company depends on management's ability to anticipate and/or to respond quickly and adequately to technological developments in its industry, changes in customer requirements, or changes in regulatory requirements or industry standards. Any significant delays in the development or introduction of products could have a material adverse effect on the Company's business and operating results.

The Company relies on a limited number of third parties to manufacture all of its products. If any of the Company's third-party manufacturers cannot or will not manufacture its products in required volumes, on a cost-effective basis, in a timely manner, or at all, the Company will have to secure additional manufacturing capacity. Any interruption or delay in manufacturing could have a material adverse effect on the Company's business and operating results.

Derivative financial instruments

The Company uses foreign currency forward contracts to manage the exposures to foreign exchange risk related to expected future cash flows on certain forecasted revenue, costs of revenue, operating expenses, and on certain existing assets and liabilities. Foreign currency forward contracts generally mature within five months of inception. Under its foreign currency risk management strategy, the Company utilizes derivative instruments to reduce the impact of currency exchange rate movements on the Company's operating results by offsetting gains and losses on the forward contracts with increases or decreases in foreign currency transactions. The company does not use derivative financial instruments for speculative purposes.

The Company accounts for its derivative instruments as either assets or liabilities and records them at fair value. Derivatives that are not defined as hedges in the authoritative guidance for derivatives and hedging must be adjusted to fair value through earnings. For derivative instruments that hedge the exposure to variability in expected future cash flows that are designated as cash flow hedges, the effective portion of the gain or loss on the derivative instrument is reported as a component of cumulative other comprehensive income in stockholders' equity and reclassified into earnings in the same period or periods during which the hedged transaction affects earnings. The ineffective portion of the gain or loss on the derivative instrument is recognized in current earnings. To receive hedge accounting treatment, cash flow hedges must be highly effective in offsetting changes to expected future cash flows on hedged transactions. For derivatives designated as cash flow hedges, changes in the time value are excluded from the assessment of hedge effectiveness and are recognized in earnings.

Concentration of credit risk

Financial instruments that potentially subject the Company to a concentration of credit risk consist of cash and cash equivalents, short-term investments and accounts receivable. The Company believes that there is minimal credit risk associated with the investment of its cash and cash equivalents and short-term investments, due to the restrictions placed on the type of investment that can be entered into under the Company's investment policy. The Company's short-term investments consist of investment-grade securities, and the Company's cash and investments are held and managed by recognized financial institutions.

The Company's customers are primarily distributors as well as retailers and broadband service providers who sell or distribute the products to a large group of end-users. The Company maintains an allowance for doubtful accounts for estimated losses resulting from the inability of the Company's customers to make required payments. The Company regularly performs credit evaluations of the Company's customers' financial condition and considers factors such as historical experience, credit quality, age of the accounts receivable balances, geographic or country-specific risks and current economic conditions that may affect customers' ability to pay, and, generally, requires no collateral from its customers. The Company secures credit insurance for certain customers in international and domestic markets.

As of December 31, 2013 and 2012, Best Buy, Inc. represented 21% and 22% of the Company's total accounts receivable respectively.

The Company is exposed to credit loss in the event of nonperformance by counterparties to the foreign currency forward contracts used to mitigate the effect of foreign currency exchange rate changes. The Company believes the counterparties for its outstanding contracts are large, financially sound institutions and thus, the Company does not anticipate nonperformance by these counterparties. However, given the recent, unprecedented turbulence in the financial markets, the failure of additional counterparties is possible.

Fair value measurements

The carrying amounts of the Company's financial instruments, including cash equivalents, short-term investments, accounts receivable, and accounts payable approximate their fair values due to their short maturities. Foreign currency forward contracts are recorded at fair value based on observable market data. See Note 13, Fair Value Measurements, of the Notes to Consolidated Financial Statements for disclosures regarding fair value measurements in accordance with the authoritative guidance for fair value measurements and disclosures.

Cost method investments

As of December 31, 2013 and December 31, 2012, the carrying value of the Company's cost method investments was $1.3 million. These investments are included in other non-current assets in the consolidated balance sheets and are carried at cost, adjusted for any impairment, because the Company does not have a controlling interest and does not have the ability to exercise significant influence over these companies. The Company monitors these investments for impairment on a quarterly basis, and adjusts carrying value for any impairment charges recognized. There were no impairments recognized in the years ended December 31, 2013 and December 31, 2012. Realized gains and losses on these investments are reported in other income (expense), net in the consolidated statements of operations. In the third fiscal quarter of 2012 the Company recognized a gain of $3.1 million on the partial sale of one of its cost method investments.

Allowance for doubtful accounts

The Company maintains an allowance for doubtful accounts for estimated losses resulting from the inability of its customers to make required payments. The Company regularly performs credit evaluations of its customers' financial condition and considers factors such as historical experience, credit quality, age of the accounts receivable balances, and geographic or country-specific risks and economic conditions that may affect a customer's ability to pay. The allowance for doubtful accounts is reviewed quarterly and adjusted if necessary based on the Company's assessments of its customers' ability to pay. If the financial condition of the Company's customers should deteriorate or if actual defaults are higher than the Company's historical experience, additional allowances may be required, which could have an adverse impact on operating expenses.

Inventories

Inventories consist primarily of finished goods which are valued at the lower of cost or market, with cost being determined using the first-in, first-out method. The Company writes down its inventories based on estimated excess and obsolete inventories determined primarily by future demand forecasts. At the point of loss recognition, a new, lower cost basis for that inventory is established, and subsequent changes in facts and circumstances do not result in the restoration or increase in that newly established cost basis.

Property and equipment, net

Property and equipment are stated at historical cost, less accumulated depreciation. Depreciation is computed using the straight-line method over the estimated useful lives of the assets as follows:

Computer equipment	2 years
Furniture and fixtures	5 years
Software	2-5 years
Machinery and equipment	2-3 years
Leasehold improvements	Shorter of the lease term or 5 years

Recoverability of assets to be held and used is measured by comparing the carrying amount of an asset to the estimated undiscounted future cash flows expected to be generated by the asset. If the carrying amount of the asset exceeds its estimated undiscounted future net cash flows, an impairment charge is recognized by the amount by which the carrying amount of the asset exceeds the fair value of the asset. The carrying value of the asset is reviewed on a regular basis for the existence of facts, both internal and external, that may suggest impairment. Charges related to the impairment of property and equipment were not material in the years ended December 31, 2013, 2012 and 2011.

Goodwill

Goodwill represents the purchase price over estimated fair value of net assets of businesses acquired in a business combination. Goodwill acquired in a business combination is not amortized, but instead tested for impairment at least annually during the fourth quarter. Should certain events or indicators of impairment occur between annual impairment tests, the Company will perform the impairment test as those events or indicators occur. Examples of such events or circumstances include the following: a significant decline in the Company's expected future cash flows; a sustained, significant decline in the Company's stock price and market capitalization; a significant adverse change in the business climate; and slower growth rates.

Goodwill is tested for impairment at the reporting unit level by first performing a qualitative assessment to determine whether it is more likely than not (that is, a likelihood of more than 50%) that the fair value of the reporting unit is less than its carrying value. The qualitative assessment considers the following factors: macroeconomic conditions, industry and market considerations, cost factors, overall company financial performance, events affecting the reporting units, and changes in the Company's share price. If the reporting unit does not pass the qualitative assessment, then the Company estimates its fair value and compare the fair value with the carrying value of its net assets. If the fair value is greater than the carrying value of its net assets, then no impairment results. If the fair value is less than its carrying value, then it would determine the fair value of the goodwill by comparing the implied fair value to the carrying value of the goodwill in the same manner as if the Company were being acquired in a business combination. Specifically, the Company would allocate the fair value to all of our assets and liabilities, including any unrecognized intangible assets, in a hypothetical analysis that would calculate the implied fair value of goodwill. If the implied fair value of goodwill is less than the recorded goodwill, an impairment charge would be recorded to earnings in the Consolidated Statements of Operations.

In the fourth fiscal quarter of 2013, we completed the annual impairment test of goodwill. Due to the increase in goodwill in fiscal year 2013 as a result of our acquisitions, we elected to bypass the qualitative assessment and proceed directly to estimating the fair value of net assets for each reporting unit. The fair value of the business units was determined placing an equal weighting of 50 percent on the income approach and market approach indications of value. Under the income approach, the fair value of an asset is based on the value of the estimated cash flows that the asset can be expected to generate in the future. These estimated future cash flows were discounted to arrive at their respective fair values. Under the market approach, the fair value of the unit is based on an analysis of financial data for publicly traded companies engaged in the same or similar lines of business. We compared the fair value of the reporting units to the reporting unit's carrying value and determined that goodwill was not impaired since the estimated fair values of each of the reporting units exceeded the carrying values. The excess of fair value over carrying amount for each of our reporting units ranged from approximately 15% to approximately 219% of carrying amounts. The service provider business unit has the lowest excess of fair value over carrying amount at 15%. In order to evaluate the sensitivity of the estimated fair values of our reporting units in the goodwill impairment test, we applied a hypothetical 10% decrease to the fair values of each reporting unit. This hypothetical 10% decrease resulted in a lowest excess of fair value over carrying amount of approximately 4% for service provider business unit. We will continue to monitor goodwill on an annual basis as of the beginning of our fourth fiscal quarter and whenever events or changes in circumstances, such as significant adverse changes in business climate or operating results, changes in management's business strategy or significant declines in our stock price, indicate that there may be potential indicator of impairment.

No goodwill impairment was recognized in the years ended December 31, 2013, 2012 or 2011.

Intangible assets

Purchased intangible assets with finite lives are amortized using the straight-line method over the estimated economic lives of the assets, which range from four to ten years. Finite-lived intangible assets are reviewed for impairment whenever events or changes in circumstances indicate that the carrying amount of such assets may not be recoverable. Determination of recoverability is based on an estimate of undiscounted future cash flows resulting from the use of the asset and its eventual disposition.

Purchased intangible assets determined to have indefinite useful lives are not amortized. Indefinite-lived intangible assets are reviewed for impairment at least annually during the fourth quarter and whenever events or changes in circumstances indicate that the carrying amount of such assets may not be recoverable. Measurement of an impairment loss for indefinite-lived assets that management expects to hold and use is based on the fair value of the asset. Indefinite-lived assets to be disposed of are reported at the lower of carrying amount or fair value less costs to sell. The carrying value of the asset is reviewed on a regular basis for the existence of facts, both internal and external, that may suggest impairment.

In the fourth fiscal quarter of 2013, the Company completed the annual impairment test of indefinite-lived long-lived assets. The Company assessed whether it was more likely than not (that is, a likelihood of more than 50%) the carrying amount of its indefinite-lived intangible assets may not be recoverable from their undiscounted cash flows by considering the following factors: macroeconomic conditions, industry and market considerations, cost factors, overall company financial performance, events affecting the reporting units, and changes in our share price. Based on these factors , the Company determined that it is not more likely than not that there were events or changes in circumstances that indicated that the carrying amount of our indefinite-lived intangible assets may not be recoverable from their undiscounted cash flows, and therefore performing the first step of the two-step impairment test for each reporting unit was unnecessary. No impairments to the indefinite-lived assets were recognized resulting from the annual impairment tests in the years ended December 31, 2013, 2012 and 2011.

In the third quarter of 2013, the Company recorded an impairment charge of $2.0 million related to the abandonment of certain IPR&D projects acquired in the AirCard acquisition. No other impairments to long-lived assets were recognized in the years ended December 31, 2013, 2012 and 2011

Product warranties

The Company provides for estimated future warranty obligations at the time revenue is recognized. The Company's standard warranty obligation to its direct customers generally provides for a right of return of any product for a full refund in the event that such product is not merchantable or is found to be damaged or defective. At the time revenue is recognized, an estimate of future warranty returns is recorded to reduce revenue in the amount of the expected credit or refund to be provided to its direct customers. At the time the Company records the reduction to revenue related to warranty returns, the Company includes within cost of revenue a write-down to reduce the carrying value of such products to net realizable value. The Company's standard warranty obligation to its end-users provides for replacement of a defective product for one or more years. Factors that affect the warranty obligation include product failure rates, material usage, and service delivery costs incurred in correcting product failures. The estimated cost associated with fulfilling the Company's warranty obligation to end-users is recorded in cost of revenue. Because the Company's products are manufactured by third-party manufacturers, in certain cases the Company has recourse to the third-party manufacturer for replacement or credit for the defective products. The Company gives consideration to amounts recoverable from its third-party manufacturers in determining its warranty liability. Changes in the Company's warranty liability, which is included as a component of “Other accrued liabilities” in the consolidated balance sheets, are as follows (in thousands):

	Year Ended December 31,			
	2013		2012	
Balance as of beginning of the period	$46,659		$44,846	
Provision for warranty liability made during the period	69,755		61,985	
Settlements made during the period	(67,660	)	(60,172	)
Balance at end of period	$48,754		$46,659	

Revenue recognition

Revenue from product sales is generally recognized at the time the product is shipped provided that persuasive evidence of an arrangement exists, title and risk of loss has transferred to the customer, the selling price is fixed or determinable and collection of the related receivable is reasonably assured. Currently, for some of the Company's customers, title passes to the customer upon delivery to the port or country of destination, upon their receipt of the product, or upon the customer's resale of the product. At the end of each fiscal quarter, the Company estimates and defers revenue related to product where title has not transferred. The revenue continues to be deferred until such time that title passes to the customer. The Company assesses collectability based on a number of factors, including general economic and market conditions, past transaction history with the customer, and the creditworthiness of the customer. If the Company determines that collection of the fee is not reasonably assured, then the Company defers the fee and recognizes revenue upon receipt of payment.

The Company has an insignificant amount of product offerings with multiple elements. The Company's multiple-element product offerings include networking hardware with embedded software, various software subscription services, and support, which are considered separate units of accounting. In general, the networking hardware with embedded software is delivered up front, while the subscription services and support are delivered over the subscription and support period. The Company allocates revenue to the software deliverables and the non-software deliverables (including software deliverables which function together with hardware deliverables to provide the product's essential functionality) based upon their relative selling price. Revenue allocated to each unit of accounting is then recognized when persuasive evidence of an arrangement exists, title and risk of loss has transferred to the customer, the selling price is fixed or determinable and collection of the related receivable is reasonably assured.

When applying the relative selling price method, the Company determines the selling price for each deliverable using vendor-specific objective evidence ("VSOE") of fair value of the deliverable, or when VSOE of fair value is unavailable, its best estimate of selling price (“ESP”), as the Company has determined it is unable to establish third-party evidence of selling price for the deliverables. In determining VSOE, the Company requires that a substantial majority of the selling prices for a deliverable sold on a stand-alone basis fall within a reasonably narrow pricing range, generally evidenced by approximately 80% of such historical stand-alone transactions falling within +/-15% of the median price. The Company determines ESP for a deliverable by considering multiple factors including, but not limited to, market conditions, competitive landscape, internal costs, gross margin objectives and pricing practices. The objective of ESP is to determine the price at which the Company would transact a sale if the deliverable were sold on a stand-alone basis. The determination of ESP is made through consultation with and formal approval by the Company's management, taking into consideration the go-to-market strategy.

Certain distributors and retailers generally have the right to return product for stock rotation purposes. Upon shipment of the product, the Company reduces revenue for an estimate of potential future product warranty and stock rotation returns related to the current period product revenue. Management analyzes historical returns, channel inventory levels, current economic trends and changes in customer demand for the Company's products when evaluating the adequacy of the allowance for sales returns, namely warranty and stock rotation returns. Revenue on shipments is also reduced for estimated price protection and sales incentives deemed to be contra-revenue under the authoritative guidance for revenue recognition.

Sales incentives

The Company accrues for sales incentives as a marketing expense if it receives an identifiable benefit in exchange and can reasonably estimate the fair value of the identifiable benefit received; otherwise, it is recorded as a reduction to revenues. As a consequence, the Company records a substantial portion of its channel marketing costs as a reduction of revenue.

The Company records estimated reductions to revenues for sales incentives at the later of when the related revenue is recognized or when the program is offered to the customer or end consumer.

Shipping and handling fees and costs

The Company includes shipping and handling fees billed to customers in net revenue. Shipping and handling costs associated with inbound freight are included in cost of revenue. In cases where the Company gives a freight allowance to the customer for their own inbound freight costs, such costs are appropriately recorded as a reduction in net revenue. Shipping and handling costs associated with outbound freight are included in sales and marketing expenses and totaled $11.6 million, $12.1 million and $13.9 million in the years ended December 31, 2013, 2012 and 2011 respectively.

Research and development

Costs incurred in the research and development of new products are charged to expense as incurred.

Advertising costs

Advertising costs are expensed as incurred. Total advertising and promotional expenses were $18.0 million, $19.0 million, and $21.7 million in the years ended December 31, 2013, 2012 and 2011 respectively.

Income taxes

The Company accounts for income taxes under an asset and liability approach. Under this method, income tax expense is recognized for the amount of taxes payable or refundable for the current year. In addition, deferred tax assets and liabilities are recognized for the expected future tax consequences of temporary differences resulting from different treatment for tax versus accounting for certain items, such as accruals and allowances not currently deductible for tax purposes. These differences result in deferred tax assets and liabilities, which are included within the consolidated balance sheet. The Company must then assess the likelihood that the Company's deferred tax assets will be recovered from future taxable income and to the extent the Company believes that recovery is not more likely than not, the Company must establish a valuation allowance.

In the ordinary course of business there is inherent uncertainty in assessing the Company's income tax positions. The Company assesses its tax positions and records benefits for all years subject to examination based on management's evaluation of the facts, circumstances and information available at the reporting date. For those tax positions where it is more likely than not that a tax benefit will be sustained, the Company records the largest amount of tax benefit with a greater than 50 percent likelihood of being realized upon ultimate settlement with a taxing authority that has full knowledge of all relevant information. For those income tax positions where it is not more likely than not that a tax benefit will be sustained, no tax benefit has been recorded in the financial statements. Where applicable, associated interest and penalties have also been recognized as a component of income tax expense.

Computation of net income per share

Basic net income per share is computed by dividing net income by the weighted average number of common shares outstanding for the period. Diluted net income per share reflects the additional dilution from potential issuances of common stock, such as stock issuable pursuant to the exercise of stock options and awards. Potentially dilutive shares are excluded from the computation of diluted net income per share when their effect is anti-dilutive.

Stock-based compensation

The Company measures stock-based compensation at the grant date based on the fair value of the award. The fair value of stock options is estimated using the Black-Scholes option pricing model. Estimated compensation cost relating to restricted stock units (“RSUs”) is based on the closing fair market value of the Company’s common stock on the date of grant. The fair value of Employee Stock Purchase Plan (“ESPP”) is based on the 15% discount at purchase, since the price of the shares is determined at the purchase date.

The compensation expense for equity awards is reduced by an estimate for forfeitures and is recognized over the vesting period of the award under a graded vesting method. In addition, the Company will recognize an excess benefit from stock-based compensation in equity based on the difference between tax expense computed with consideration of the windfall deduction and without consideration of the windfall deduction. In addition, the Company accounts for the indirect effects of stock-based compensation on the research tax credit and the foreign tax credit in the income statement. See Note 11, Employee Benefit Plans, of the Notes to Consolidated Financial Statements for a further discussion on stock-based compensation.

Comprehensive income

Comprehensive income consists of net income and other gains and losses affecting stockholder's equity that the Company excluded from net income, including gains and losses related to fair value of short-term investments and the effective portion of cash flow hedges that were outstanding as of the end of the year.

Foreign currency translation

The Company's functional currency is the U.S. dollar for all of its international subsidiaries. Foreign currency transactions of international subsidiaries are re-measured into U.S. dollars at the end-of-period exchange rates for monetary assets and liabilities, and historical exchange rates for non-monetary assets. Expenses are re-measured at average exchange rates in effect during each period, except for expenses related to non-monetary assets, which are re-measured at historical exchange rates. Revenue is re-measured at average exchange rates in effect during each period. Gains and losses arising from foreign currency transactions are included in total comprehensive income and were a net loss of $1.6 million for the year ended December 31, 2013, a net gain of $0.2 million for the year ended December 31, 2012 and a net gain of $0.1 million for the year ended December 31, 2011.

Recent accounting pronouncements

In March 2013, the FASB issued ASU 2013-05, "Foreign Currency Matters," which provides the standards for parent's accounting for the cumulative translation adjustment upon derecognition of certain subsidiaries or groups of assets within a foreign entity or of an investment in a foreign entity. ASU 2013-05 is effective for reporting periods beginning after December 15, 2013. The Company will adopt this standard in the first quarter of 2014 and it does not expect the adoption to have a significant impact on its financial position, results of operations or cash flows.

In July 2013, the FASB issued ASU 2013-11, "Income Taxes," which provides explicit guidance on the financial statement presentation of an unrecognized tax benefit when a net operating loss carryforward or a tax credit carryforward exists. Under the new standard update, the Company’s unrecognized tax benefit, or a portion of an unrecognized tax benefit, should be presented in the financial statements as a reduction to a deferred tax asset for a net operating loss carryforward or a tax credit carryforward. ASU 2013-11 is effective for the Company beginning in the first quarter fiscal 2014 and applied prospectively or retroactively with early adoption permitted. The Company has adopted ASU 2013-11 during the three months ended December 31, 2013 on a prospective basis. It does not have a significant impact on the Company's financial position, results of operations or cash flows.

Note 2. Business Acquisitions

Arada Systems, Inc.

On June 21, 2013, the Company acquired certain assets and operations of Arada Systems, Inc. (“Arada”), a privately-held company that develops, licenses, and provides solutions for the next generation of uses of Wi-Fi, for total purchase consideration of $5.2 million in cash. The Company believes the acquisition will bolster its wireless product offerings in its commercial business unit and strengthen its market position in the small to medium size campus wireless LAN market. The Company paid $4.2 million of the aggregate purchase price in the second quarter of 2013, and expects to pay the remaining $1.1 million, less amounts used to satisfy certain claims, twelve months after the closing of the acquisition.

The acquisition qualified as a business combination and was accounted for using the acquisition method of accounting. The results of Arada have been included in the consolidated financial statements since the date of acquisition. Pro forma results of operations for the acquisition are not presented as the financial impact to the Company's consolidated results of operations is not material.

The allocation of the purchase price was as follows (in thousands):

Property and equipment, net	$15
Intangible assets, net	4,040
Goodwill	1,195
Total purchase price	$5,250

The fair values for tangible and intangible assets acquired and liabilities assumed were based on estimates of their fair values as of the acquisition date. These estimates are subject to revision, which may result in adjustments to the values presented above. We expect to finalize these amounts within twelve months from the acquisition date.

Of the $1.2 million of goodwill recorded on the acquisition of Arada, approximately $0.7 million and $1.2 million are deductible for U.S. federal and state income tax purposes, respectively. The goodwill recognized, which was assigned to the Company's commercial business unit, is primarily attributable to expected synergies resulting from the acquisition.

The Company designated $4.0 million of the acquired intangible assets as technology. The value was calculated based on the present value of the future estimated cash flows derived from estimated savings attributable to the existing technology and discounted at 21.5%. The acquired existing technology is being amortized over its estimated useful life of five years.

AirCard Division of Sierra Wireless, Inc.
On April 2, 2013, the Company completed the acquisition of select assets and operations of the Sierra Wireless, Inc. AirCard business ("AirCard"), including customer relationships, a world-class LTE engineering team, certain intellectual property, inventory and property and equipment. The Company believes this acquisition will accelerate the mobile initiative of the service provider business unit to become a global leader in providing the latest in LTE data networking access devices.

The Company paid $140.0 million of the aggregate purchase price in the second quarter of 2013. The acquisition qualified as a business combination and was accounted for using the acquisition method of accounting. The results of AirCard have been included in the consolidated financial statements since the date of acquisition. Revenue and earnings for AirCard as of the acquisition date are not presented as the business was fully integrated into the service provider business unit subsequent to the acquisition and therefore impracticable for the Company to quantify.

The allocation of the purchase price was as follows (in thousands):

Inventories	$2,874
Prepaid expenses	9,030
Other assets	3,226
Property and equipment, net	7,455
Intangible assets, net	69,700
Goodwill	53,841
Liabilities assumed	(6,096)
Total purchase price	$140,030

In the third quarter of 2013, the Company made an adjustment of $0.5 million to goodwill related to revised inventory estimates. The fair values for tangible and intangible assets acquired and liabilities assumed are based on estimates of their fair values as of the acquisition date. These estimates are subject to revision, which may result in adjustments to the values presented above. We expect to finalize these amounts within twelve months from the acquisition date.

Of the $53.8 million of goodwill recorded on the acquisition of AirCard, approximately $36.6 million, $2.3 million and $53.8 million is deductible for U.S. federal, Canadian, and U.S. state income tax purposes, respectively. The goodwill recognized, which was assigned to the Company's service provider business unit, is primarily attributable to expected synergies resulting from the acquisition.

The Company designated $16.3 million of the acquired intangible assets as technology. The value was calculated based on the present value of the future estimated cash flows derived from estimated savings attributable to the existing technology and discounted at 10.0%. The acquired technology is being amortized over its estimated useful life of four years.

The Company designated $40.5 million of the acquired intangible assets as customer relationships. The value was calculated based on the present value of the future estimated cash flows derived from projections of future operations attributable to existing customer relationships and discounted at 12.0%. The acquired customer relationships are being amortized over an estimated useful life of eight years

The Company designated $2.3 million of the acquired intangible assets as non-compete agreements. The value was calculated based on the present value of the future estimated cash flows derived from projections of future operations attributable to the non-compete agreements and discounted at 12.0%. The acquired agreements are being amortized over an estimated useful life of five years.

The Company designated $1.1 million of the acquired intangible assets as backlog. The value was calculated based on the present value of the future contractual revenue and discounted at 10.0%. The acquired backlog was fully amortized in the second quarter of 2013.

The Company acquired $9.5 million in in-process research and development (“IPR&D”) projects. The value was calculated based on the present value of future estimated cash flows discounted at 13.0%, derived from projections of future revenues attributable to the assets, expected economic life of the assets, and royalty rates. The IPR&D acquired is considered indefinite lived intangible assets until research and development efforts associated with the projects are completed or abandoned. The most significant of the acquired IPR&D projects relate to multimode LTE technologies, Mobile Hot Spot, USB dongle, and Module form factors. As of December 31, 2013, $7.4 million of the acquired IPR&D has reached technical feasibility and was reclassified to definite-lived intangibles and with an estimated useful life of four years. In addition, the Company recorded an impairment charge of $2.0 million in the third quarter of 2013, related to the abandonment of certain IPR&D projects acquired. The Company expects to complete the remaining $0.1 million in IPR&D projects, at an estimated cost of $0.2 million, by the second quarter of 2014.

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Pro forma financial information
The unaudited pro forma financial information in the table below summarizes the combined results of our operations and those of AirCard for the periods shown as though the acquisition of AirCard occurred as of the beginning of the fiscal year 2012. The pro forma financial information for the periods presented includes the accounting effects of the business combination, including adjustments to the amortization of intangible assets, fair value of acquired inventory, acquisition-related costs, integration expenses and related tax effects of these adjustments, where applicable. This information is for informational purposes only, is subject to a number of estimates, assumptions and other uncertainties, and may not be indicative of the results of operations that would have been achieved if the acquisition had taken place at January 1, 2012.
The unaudited pro forma financial information is as follows (in thousands):

	Years Ended December 31, 2013	December 31, 2012
	(in millions)	
Revenue	$1,415	$1,519
Net income	$57	$89

AVAAK, Inc.
On July 2, 2012, the Company acquired 100% of the voting equity interests of AVAAK, Inc. (“AVAAK”), a privately-held company that developed wire-free video networking products for total purchase consideration of $24.0 million in cash. The Company believes the acquisition will bolster its retail business unit product offerings and expand its presence into the smart home market. The Company paid $21.6 million of the aggregate purchase price in the third quarter of 2012, and the remaining $2.4 million was paid in the third quarter of 2013.
The acquisition qualified as a business combination and was accounted for using the acquisition method of accounting. The results of AVAAK have been included in the consolidated financial statements since the date of acquisition. Pro forma results of operations for the acquisition are not presented as the financial impact to the Company's consolidated results of operations is not material.
The allocation of the purchase price was as follows (in thousands):

Net tangible assets acquired	$172
Deferred tax assets, net	5,937
Intangible assets, net	6,000
Goodwill	11,895
Total consideration	$24,004

None of the goodwill recognized related to AVAAK is deductible for income tax purposes. The goodwill recognized, which was assigned to the Company's retail business unit, is primarily attributable to expected synergies resulting from the acquisition.
In connection with the acquisition, the Company recorded $5.9 million of deferred tax assets net of deferred tax liabilities. The deferred tax assets arise from the tax benefit of the estimated net operating losses as of the date of the acquisition after consideration of limitations on the use under U.S. Internal Revenue Code section 382. The deferred tax assets are reduced by deferred tax liabilities recorded for the book basis in intangible assets and in-process research and development ("IPR&D") for which the Company has no tax basis.
The Company designated $2.3 million of the acquired intangible assets as technology. The value was calculated based on the present value of the future estimated cash flows derived from estimated savings attributable to the existing technology and discounted at 14.0%. The acquired existing technology is being amortized over its estimated useful life of five years.
The Company designated $0.3 million of the acquired intangible assets as customer relationships. The value was calculated based on the present value of the future estimated cash flows derived from projections of future operations attributable to existing customer relationships and discounted at 14.0%. The acquired customer relationships are being

amortized over an estimated useful life of five years.

The Company designated $1.4 million of the acquired intangible assets as trade name and trademarks. The value was calculated based on the present value of the future estimated cash flows derived from projections of future operations attributable to existing trade name and trademarks and discounted at 16.0%. The acquired trade name and trademarks are being amortized over an estimated useful life of five years.

In addition, $2.0 million of the consideration paid represents the fair value of acquired IPR&D projects. The IPR&D acquired is considered indefinite lived intangible assets until research and development efforts associated with the projects are completed or abandoned. The most significant of the acquired IPR&D projects relate to camera technology and applications. As of the first fiscal quarter of 2013, all of the acquired IPR&D had reached technical feasibility and was reclassified to definite intangibles with an estimated useful life of four years.

Firetide, Inc.

On June 4, 2012, the Company acquired certain intellectual property of Firetide, Inc. (“Firetide”) for an aggregate purchase price of $7.2 million in cash. The acquisition included intangible assets that existed at the closing date, including IP contracts, technology assets, business technology, and goodwill. The Company believes the acquisition will bolster its wireless product offerings in its commercial business unit and strengthen its market position in the small to medium size campus wireless LAN market.

The acquisition qualified as a business combination and was accounted for using the acquisition method of accounting. The results of Firetide have been included in the consolidated financial statements since the date of acquisition. Pro forma results of operations for the acquisition are not presented as the financial impact to the Company's consolidated results of operations is not material.

The Company paid $6.6 million of the aggregate purchase price in the second quarter of 2012, and the remaining $0.6 million was paid in the second fiscal quarter of 2013. The ongoing costs of developing these assets subsequent to the date of acquisition have been included in the consolidated financial statements since the date of acquisition. The historical results of operations related to the acquired assets prior to the acquisition were not material to the Company’s results of operations.

The allocation of the purchase price was as follows (in thousands):

Intangible assets, net	$4,159
Goodwill	3,041
Total consideration	$7,200

Of the $3.0 million of goodwill recorded on the acquisition of Firetide, approximately $1.6 million and $3.0 million is deductible for U.S. federal and state income tax purposes, respectively. The goodwill recognized, which was assigned to the Company's commercial business unit, is primarily attributable to expected synergies and the assembled workforce of Firetide.

The Company designated the $4.2 million in acquired intangible assets as technology. The value was calculated based on the present value of the future estimated cash flows derived from estimated savings attributable to the existing technology and discounted at 22.0%. The acquired existing technology is being amortized over its estimated useful life of five years.

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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)

Note 3. Balance Sheet Components (in thousands)

Short-Term Investments

	As of December 31, 2013				December 31, 2012			
	Cost	Unrealized Gain	Unrealized Loss	Estimated Fair Value	Cost	Unrealized Gain	Unrealized Loss	Estimated Fair Value
U.S. Treasuries	$104,595	$7	$(1)	$104,601	$225,016	$48	$(2)	$225,062
Certificates of Deposits	159	—	—	159	2,783	—	—	2,783
Mutual Funds	385	—	—	385	—	—	—	—
Total	$105,139	$7	$(1)	$105,145	$227,799	$48	$(2)	$227,845

The Company’s marketable securities are classified as available-for-sale consisting of government securities and trading securities consisting of mutual funds. All the securities are with an original maturity or remaining maturity at the time of purchase of greater than three months and no more than 12 months. Accordingly, none of the short-term investments have unrealized losses greater than 12 months.

Cost Method Investments

As of December 31, 2013 and December 31, 2012, the carrying value of the Company's cost method investments was $1.3 million. These investments are included in other non-current assets in the consolidated balance sheets and are carried at cost, adjusted for any impairment, because the Company does not have a controlling interest and does not have the ability to exercise significant influence over these companies. The Company monitors these investments for impairment on a quarterly basis, and adjusts carrying value for any impairment charges recognized. There were no impairments recognized in the years ended December 31, 2013 and December 31, 2012. Realized gains and losses on these investments are reported in other income (expense), net in the consolidated statements of operations. In the third fiscal quarter of 2012 the Company recognized a gain of $3.1 million on the partial sale of one of its cost method investments. No other gains or losses were recorded in the years ended December 31, 2013 and December 31, 2012.

Accounts receivable, net

	As of December 31, 2013	December 31, 2012
Gross accounts receivable	$289,479	$276,084
Allowance for doubtful accounts	(1,255)	(1,256)
Allowance for sales returns	(17,467)	(17,031)
Allowance for price protection	(4,273)	(1,783)
Total allowances	(22,995)	(20,070)
Total accounts receivable, net	$266,484	$256,014

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Inventories

	As of December 31, 2013	December 31, 2012
Raw materials	$8,676	$4,447
Work-in-process	6,233	—
Finished goods	209,547	170,456
Total inventories	$224,456	$174,903

The Company records provisions for excess and obsolete inventory based on forecasts of future demand. While management believes the estimates and assumptions underlying its current forecasts are reasonable, there is risk that additional charges may be necessary if current forecasts are greater than actual demand.

Property and equipment, net

	As of December 31, 2013	December 31, 2012
Computer equipment	$8,527	$7,290
Furniture, fixtures and leasehold improvements	14,019	12,761
Software	25,722	21,521
Machinery and equipment	50,656	31,694
Construction in progress	21	385
Total property and equipment, gross	98,945	73,651
Accumulated depreciation and amortization	(71,751)	(54,626)
Total property and equipment, net	$27,194	$19,025

Depreciation and amortization expense pertaining to property and equipment was $17.3 million, $11.9 million and $9.9 million for the years ended December 31, 2013, 2012 and 2011, respectively.

Intangibles, net

The following tables present details of the Company's purchased intangible assets:

	Gross	Accumulated Amortization	Net
December 31, 2013			
Technology	$60,999	$(29,593)	$31,406
Customer contracts and relationships	56,500	(9,120)	47,380
Other	10,545	(5,313)	5,232
Finite-lived intangibles, net	128,044	(44,026)	84,018
Indefinite-lived intangible assets	100	—	100
Total purchased intangible assets, net	$128,144	$(44,026)	$84,118

NETGEAR, INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)

	Gross	Accumulated Amortization	Net
December 31, 2012			
Technology	$32,259	$(22,065)	$10,194
Customer contracts and relationships	16,000	(3,301)	12,699
Other	6,870	(3,142)	3,728
Finite-lived intangibles, net	55,129	(28,508)	26,621
Indefinite-lived intangible assets	1,000	—	1,000
Total purchased intangible assets, net	$56,129	$(28,508)	$27,621

The Company purchased finite-lived intangible assets of $64.2 million and indefinite-lived assets of $9.5 million, as a result of its acquisition of AirCard and Arada during the second quarter of 2013. For further discussion regarding the AirCard and Arada acquisitions, see Note 2, Business Acquisitions. In addition, the Company purchased $0.3 million in patents during the second quarter of 2013.

As of December 31, 2013, the Company had $0.1 million in indefinite-lived intangible assets. This balance relates to the remaining IPR&D assets acquired in connection with the Company's acquisition of AirCard. IPR&D assets represent IPR&D projects that have not reached technical feasibility and are required to be classified as indefinite-lived assets until the successful completion or abandonment of the associated research and development efforts. Accordingly, during the development period after the date of acquisition, these assets will not be amortized. When the asset reaches technical feasibility, the Company will determine the useful life of the asset, reclassify the asset out of IPR&D, and begin amortization. Development costs incurred after acquisition on acquired IPR&D projects are expensed as incurred. As of December 31, 2013, $7.4 million of the IPR&D had reached technical feasibility and as a result, was reclassified from IPR&D to technology. In addition, $2.0 million of IPR&D projects were abandoned during the third quarter of 2013. The Company expects to complete the remaining IPR&D by the second quarter of 2014, for an estimated future cost to complete of $0.2 million.

Amortization of purchased intangible assets in the years ended December 31, 2013, 2012 and 2011 was $15.5 million, $4.9 million and $4.8 million, respectively. In the year ended December 31, 2013, the Company recorded an impairment charge of $2.0 million due to the abandonment of IPR&D discussed above. No impairment charges were recorded in the years ended December 31, 2012 and 2011.

Estimated amortization expense related to finite-lived intangibles for each of the next five years and thereafter is as follows:

Year Ending December 31,	Amount
2014	$17,875
2015	17,258
2016	16,896
2017	11,361
2018	7,859
Thereafter	12,769
Total expected amortization expense	$84,018

Goodwill

The changes in the carrying amount of goodwill during the years ended December 31, 2013 and 2012 are as follows:

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	Retail	Commercial	Service Provider	Total
Goodwill at December 31, 2011	$33,546	$32,043	$20,355	$85,944
Goodwill acquired during the period	11,895	3,041	—	14,936
Goodwill at December 31, 2012	45,441	35,084	20,355	100,880
Goodwill acquired during the period	—	1,195	53,841	55,036
Goodwill at December 31, 2013	$45,441	$36,279	$74,196	$155,916

During 2013, the Company recorded goodwill of $55.0 million, related to its acquisitions of AirCard and Arada, including an adjustment of $0.5 million to goodwill, related to a change in the estimated fair value of inventory acquired in the AirCard acquisition. Refer to Note 2, Business Acquisitions, for additional information regarding the Company's acquisitions.

There were no impairments to goodwill in the years ended December 31, 2013, 2012 and 2011. Refer to Note 1, The Company and Summary of Significant Accounting Policies, for additional information regarding the Company's goodwill impairment assessment.

Other non-current assets

	As of December 31, 2013	December 31, 2012
Non-current deferred income taxes	$20,235	$16,856
Cost method investment	1,322	1,322
Other	5,034	4,656
Total other non-current assets	$26,591	$22,834

Other accrued liabilities

	As of December 31, 2013	December 31, 2012
Sales and marketing programs	$47,941	$43,652
Warranty obligation	48,754	46,659
Freight	5,790	4,457
Other	40,733	31,487
Total other accrued liabilities	$143,218	$126,255

Note 4. Restructuring and Other Charges

The Company accounts for its restructuring plans under the authoritative guidance for exit or disposal activities. The Company presents expenses related to restructuring and other charges as a separate line item in its Consolidated Statements of Operations.

During the year ended December 31, 2013, the Company incurred restructuring and other charges of $5.4 million. Restructuring charges consisted of $3.3 million in severance costs related to the consolidation of certain teams and locations during the fourth quarter of 2013, and $0.2 million related to an office lease exit liability related to the AVAAK acquisition. Other charges consisted of $1.9 million in transition costs related to the AirCard acquisition. In addition, the Company recorded a restructuring adjustment of $94,000 to decrease the previously recorded severance liability for an office lease exit related to the AVAAK acquisition and the consolidation of product groups within the commercial business units. The Company expects to pay the remaining cost related to restructuring over the next three months. Refer to Note 2, Business Acquisitions for additional information regarding the AirCard and AVAAK acquisitions. During the year ended December 31, 2012, the Company incurred $1.2 million in restructuring costs for employee severance related to the consolidation of product groups within our commercial business unit.

The following tables provide a summary of accrued restructuring and other charges activity:

	Accrued Restructuring and Other Charges at December 31, 2012	Additions	Cash Payments	Adjustments	Accrued Restructuring and Other Charges at December 31, 2013
	(In thousands)				
Restructuring	$999	$3,537	$(3,429)	$(94)	$1,013
Acquisition transition costs	—	1,892	(1,882)	—	10
Restructuring and other charges	$999	$5,429	$(5,311)	$(94)	$1,023

	Accrued Restructuring and Other Charges at December 31, 2011	Additions	Cash Payments	Adjustments	Accrued Restructuring and Other Charges at December 31, 2012
	(In thousands)				
Restructuring	$—	$1,190	$(191)	$—	$999

Note 5. Derivative Financial Instruments

The Company’s subsidiaries have had, and will continue to have material future cash flows, including revenue and expenses, which are denominated in currencies other than the Company’s functional currency. The Company and all its subsidiaries designate the U.S. dollar as the functional currency. Changes in exchange rates between the Company’s functional currency and other currencies in which the Company transacts business will cause fluctuations in cash flow expectations and cash flow realized or settled. Accordingly, the Company uses derivatives to mitigate its business exposure to foreign exchange risk. The Company enters into foreign currency forward contracts in Australian dollars, British pounds, Euros, and Japanese yen to manage the exposures to foreign exchange risk related to expected future cash flows on certain forecasted revenue, costs of revenue, operating expenses and existing assets and liabilities. The Company does not enter into derivatives transactions for trading or speculative purposes.

The Company's foreign currency forward contracts do not contain any credit-risk-related contingent features. The Company is exposed to credit losses in the event of nonperformance by the counter-parties of its forward contracts. The Company enters into derivative contracts with high-quality financial institutions and limits the amount of credit exposure to any one counter-party. In addition, the derivative contracts typically mature in less than six months and the Company continuously evaluates the credit standing of its counter-party financial institutions. The counter-parties to these arrangements are large highly rated financial institutions and the Company does not consider non-performance a material risk.

The Company may choose not to hedge certain foreign exchange exposures for a variety of reasons, including, but not limited to, immateriality, accounting considerations and the prohibitive economic cost of hedging particular exposures. There can be no assurance the hedges will offset more than a portion of the financial impact resulting from movements in foreign exchange rates. The Company's accounting policies for these instruments are based on whether the instruments are designated as hedge or non-hedge instruments in accordance with the authoritative guidance for derivatives and hedging. The Company records all derivatives on the balance sheet at fair value. The effective portions of cash flow hedges are recorded in other comprehensive income until the hedged item is recognized in earnings. Derivatives that are not designated as hedging instruments and the ineffective portions of its designated hedges are adjusted to fair value through earnings in other income (expense), net in the consolidated statement of operations.

The fair values of the Company’s derivative instruments and the line items on the consolidated balance sheet to which they were recorded as of December 31, 2013, and December 31, 2012, are summarized as follows (in thousands):

Derivative Assets	Balance Sheet Location	Fair value at December 31, 2013	Balance Sheet Location	Fair value at December 31, 2012
Derivative assets not designated as hedging instruments	Prepaid expenses and other current assets	$842	Prepaid expenses and other current assets	$1,142
Derivative assets designated as hedging instruments	Prepaid expenses and other current assets	63	Prepaid expenses and other current assets	2
Total		$905		$1,144

Derivative Liabilities	Balance Sheet Location	Fair value at December 31, 2013	Balance Sheet Location	Fair value at December 31, 2012
Derivative liabilities not designated as hedging instruments	Other accrued liabilities	$(368)	Other accrued liabilities	$(1,616)
Derivative liabilities designated as hedging instruments	Other accrued liabilities	(13)	Other accrued liabilities	(3)
Total		$(381)		$(1,619)

For details of the Company’s fair value measurements, see Note 13, Fair Value Measurements.

Offsetting Derivative Assets and Liabilities

The Company has entered into master netting arrangements which allow net settlements under certain conditions. Although netting is permitted, it is currently the Company's policy and practice to record all derivative assets and liabilities on a gross basis in the condensed consolidated balance sheets.

The following tables set forth the offsetting of derivative assets as of December 31, 2013 and December 31, 2012 (in thousands):

As of December 31, 2013				Gross Amounts Not Offset in the Condensed Consolidated Balance Sheets		
	Gross Amounts of Recognized	Gross Amounts Offset in the	Net Amounts Of Assets Presented in the	Financial Instruments	Cash Collateral Pledged	Net Amount

	Assets	Condensed Consolidated Balance Sheets	Condensed Consolidated Balance Sheets			
Barclays	$905	$—	$905	$(287)	$—	$618
Wells Fargo Bank	—	—	—	—	—	—
Total	$905	$—	$905	$(287)	$—	$618

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As of December 31, 2012	Gross Amounts of Recognized Assets	Gross Amounts Offset in the Condensed Consolidated Balance Sheets	Net Amounts Of Assets Presented in the Condensed Consolidated Balance Sheets	Gross Amounts Not Offset in the Condensed Consolidated Balance Sheets		
				Financial Instruments	Cash Collateral Pledged	Net Amount
Barclays	$1,107	$—	$1,107	$(1,107)	$—	$—
Wells Fargo Bank	37	—	37	(37)	—	—
Total	$1,144	$—	$1,144	$(1,144)	$—	$—

The following tables set forth the offsetting of derivative liabilities as of December 31, 2013 and December 31, 2012 (in thousands):

As of December 31, 2013	Gross Amounts of Recognized Liabilities	Gross Amounts Offset in the Condensed Consolidated Balance Sheets	Net Amounts Of Liabilities Presented in the Condensed Consolidated Balance Sheets	Gross Amounts Not Offset in the Condensed Consolidated Balance Sheets		
				Financial Instruments	Cash Collateral Pledged	Net Amount
Barclays	$287	$—	$287	$(287)	$—	$—
Wells Fargo Bank	94	—	94	—	—	94
Total	$381	$—	$381	$(287)	$—	$94

As of December 31, 2012	Gross Amounts of Recognized Liabilities	Gross Amounts Offset in the Condensed Consolidated Balance Sheets	Net Amounts Of Liabilities Presented in the Condensed Consolidated Balance Sheets	Gross Amounts Not Offset in the Condensed Consolidated Balance Sheets		
				Financial Instruments	Cash Collateral Pledged	Net Amount
Barclays	$1,401	$—	$1,401	$(1,107)	$—	$294
Wells Fargo Bank	218	—	218	(37)	—	181
Total	$1,619	$—	$1,619	$(1,144)	$—	$475

Cash flow hedges

To help manage the exposure of operating margins to fluctuations in foreign currency exchange rates, the Company hedges a portion of its anticipated foreign currency revenue, costs of revenue and certain operating expenses. These hedges are designated at the inception of the hedge relationship as cash flow hedges under the authoritative guidance for derivatives and hedging. Effectiveness is tested at least quarterly both prospectively and retrospectively using regression analysis to ensure that the hedge relationship has been effective and is likely to remain effective in the future. The Company typically hedges portions of its anticipated foreign currency exposure for three to five months. The Company enters into about five forward contracts per quarter with an average size of about $7 million USD equivalent related to its cash flow hedging program.

The Company expects to reclassify to earnings all of the amounts recorded in other comprehensive income ("OCI") associated with its cash flow hedges over the next 12 months. OCI associated with cash flow hedges of foreign currency revenue is recognized as a component of net revenue in the same period as the related revenue is recognized. OCI associated with cash flow hedges of foreign currency costs of revenue and operating expenses are recognized as a component of cost of revenue and operating expense in the same period as the related costs of revenue and operating expenses are recognized.

Derivative instruments designated as cash flow hedges must be de-designated as hedges when it is probable the forecasted hedged transaction will not occur within the designated hedge period or if not recognized within 60 days following the end of the

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hedge period. Deferred gains and losses in other comprehensive income associated with such derivative instruments are reclassified immediately into earnings through other income and expense. Any subsequent changes in fair value of such derivative instruments also are reflected in current earnings unless they are re-designated as hedges of other transactions. The Company did not recognize any material net gains or losses related to the loss of hedge designation on discontinued cash flow hedges during the years ended December 31, 2013, 2012 and 2011.

The effects of the Company's derivative instruments on OCI and the consolidated statement of operations for the years ended December 31, 2013, 2012 and 2011 are summarized as follows (in thousands):

	Year Ended December 31, 2013				
Derivatives Designated as Hedging Instruments	Gain or (Loss) Recognized in OCI - Effective Portion (a)	Location of Gain or (Loss) Reclassified from OCI into Income - Effective Portion	Gain or (Loss) Reclassified from OCI into Income - Effective Portion (a)	Location of Gain or (Loss) Recognized in Income and Excluded from Effectiveness Testing	Amount of Gain or (Loss) Recognized in Income and Excluded from Effectiveness Testing
Cash flow hedges:					
Foreign currency forward contracts	$775	Net revenue	$844	Other income (expense), net	$ (117)
Foreign currency forward contracts	—	Cost of revenue	(9)	Other income (expense), net	—
Foreign currency forward contracts	—	Operating expenses	(149)	Other income (expense), net	—
Total	$775		$686		$ (117)

	Year Ended December 31, 2012				
Derivatives Designated as Hedging Instruments	Gain or (Loss) Recognized in OCI - Effective Portion (a)	Location of Gain or (Loss) Reclassified from OCI into Income - Effective Portion	Gain or (Loss) Reclassified from OCI into Income - Effective Portion (a)	Location of Gain or (Loss) Recognized in Income and Excluded from Effectiveness Testing	Amount of Gain or (Loss) Recognized in Income and Excluded from Effectiveness Testing
Cash flow hedges:					
Foreign currency forward contracts	$164	Net revenue	$262	Other income (expense), net	$ (158)
Foreign currency forward contracts	—	Cost of revenue	(1)	Other income (expense), net	—
Foreign currency forward contracts	—	Operating expenses	(67)	Other income (expense), net	—
Total	$164		$194		$ (158)

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	Year Ended December 31, 2011				
Derivatives Designated as Hedging Instruments	Gain or (Loss) Recognized in OCI - Effective Portion (a)	Location of Gain or (Loss) Reclassified from OCI into Income - Effective Portion	Gain or (Loss) Reclassified from OCI into Income - Effective Portion (a)	Location of Gain or (Loss) Recognized in Income and Excluded from Effectiveness Testing	Amount of Gain or (Loss) Recognized in Income and Excluded from Effectiveness Testing
Cash flow hedges:					
Foreign currency forward contracts	$542	Net revenue	$967	Other income (expense), net	$ (310)
Foreign currency forward contracts	—	Cost of revenue	(4)	Other income (expense), net	—
Foreign currency forward contracts	—	Operating expenses	(154)	Other income (expense), net	—
Total	$542		$809		$ (310)

(a) Refer to Note 10, Stockholders' Equity, which summarizes the cumulative other comprehensive income activity related to derivatives.

The Company did not recognize any net gain or loss related to the ineffective portion of cash flow hedges during the years ended December 31, 2013, 2012 and 2011.

Non-designated hedges

The Company enters into non-designated hedges under the authoritative guidance for derivatives and hedging to manage the exposure of non-functional currency monetary assets and liabilities held on its financial statements to fluctuations in foreign currency exchange rates, as well as to reduce volatility in other income and expense. The non-designated hedges are generally expected to offset the changes in value of its net non-functional currency asset and liability position resulting from foreign exchange rate fluctuations. Foreign currency denominated accounts receivable and payable are hedged with non-designated hedges when the related anticipated foreign revenue and expenses are recognized in the Company’s financial statements. The Company also hedges certain non-functional currency monetary assets and liabilities that may not be incorporated into the cash flow hedge program. The Company adjusts its non-designated hedges monthly and enters into about 13 non-designated derivatives per quarter. The average size of its non-designated hedges is about $2 million USD equivalent and these hedges normally range from one to five months in duration.

The effects of the Company’s derivatives not designated as hedging instruments in other income (expense), net in the consolidated statements of operations for the years ended December 31, 2013 and 2012, are as follows (in thousands):

Derivatives Not Designated as Hedging Instruments	Location of Gains or (Losses) Recognized in Income on Derivative	Amount of Gains or (Losses) Recognized in Income on Derivative	
		Year Ended December	Year Ended December 31, 2012

		31, 2013	
Foreign currency forward contracts	Other (expense) income, net	458	$ (502)

Note 6. Net Income Per Share

Basic net income per share is computed by dividing the net income for the period by the weighted average number of common shares outstanding during the period. Diluted net income per share is computed by dividing the net income for the period by the weighted average number of shares of common stock and potentially dilutive common stock outstanding during the period. Potentially dilutive common shares include outstanding stock options and unvested restricted stock awards, which are reflected in diluted net income per share by application of the treasury stock method. Under the treasury stock method, the amount that the employee must pay for exercising stock options, the amount of stock-based compensation cost for future services that the Company has not yet recognized, and the estimated tax benefit that would be recorded in additional paid-in capital upon exercise are assumed to be used to repurchase shares.

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Net income per share for the years ended December 31, 2013, 2012 and 2011 are as follows (in thousands, except per share data):

	Year Ended December 31, 2013	December 31, 2012	December 31, 2011
Net income	$55,217	$86,539	$91,368
Weighted average shares outstanding:			
Basic	38,379	38,057	37,121
Dilutive potential common shares	569	690	811
Total diluted	38,948	38,747	37,932
Basic net income per share	$1.44	$2.27	$2.46
Diluted net income per share	$1.42	$2.23	$2.41

Common stock equivalents excluded from net income per diluted share because their effect would have been anti-dilutive totaled 2.8 million, 2.6 million and 2.0 million shares for the years ended December 31, 2013, 2012 and 2011, respectively.

Note 7. Other (Expense) Income, Net

Other income (expense), net consisted of the following (in thousands):

	Year Ended December 31,		
	2013	2012	2011
Foreign currency transaction (loss) gain, net	$(1,592)	$204	$131
Foreign currency contract gain (loss), net	341	(660)	(1,267)
Other	794	3,126	—
Total	$(457)	$2,670	$(1,136)

Note 8. Income Taxes

Income before income taxes consists of the following (in thousands):

	Year Ended December 31,		
	2013	2012	2011
United States	$91,318	$102,159	$79,318
International	1,664	27,123	44,892
Total	$92,982	$129,282	$124,210

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	Year Ended December 31,		
	2013	2012	2011
Current:			
U.S. Federal	$30,989	$34,666	$27,415
State	3,751	4,555	3,319
Foreign	11,224	6,097	6,760
	45,964	45,318	37,494
Deferred:			
U.S. Federal	(6,741)	(2,069)	(3,151)
State	(1,164)	(588)	(713)
Foreign	(294)	82	(788)
	(8,199)	(2,575)	(4,652)
Total	$37,765	$42,743	$32,842

Net deferred tax assets consist of the following (in thousands):

	Year Ended December 31,	
	2013	2012
Deferred Tax Assets:		
Accruals and allowances	$24,488	$20,738
Net operating loss carryforwards	7,069	7,837
Stock-based compensation	11,061	8,133
Deferred rent	1,963	2,258
Deferred revenue	1,535	1,552
Tax credit carryforwards	1,183	1,410
Acquired intangible assets	1,791	—
Other	—	261
	49,090	42,189
Deferred Tax Liabilities:		
Acquired intangible assets	—	(1,107)
Depreciation and amortization	(1,514)	(1,535)
Other	(102)	—
	(1,616)	(2,642)
Net deferred tax assets	47,474	39,547
Current portion	27,239	22,691
Non-current portion	20,235	16,856
Net deferred tax assets	$47,474	$39,547

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Management's judgment is required in determining the Company's provision for income taxes, its deferred tax assets and any valuation allowance recorded against its deferred tax assets. In management's judgment it is more likely than not that such assets will be realized in the future as of December 31, 2013, and as such no valuation allowance has been recorded against the Company's deferred tax assets.

The effective tax rate differs from the applicable U.S. statutory federal income tax rate as follows:

	Year Ended December 31,					
	2013		2012		2011	
Tax at federal statutory rate	35.0	%	35.0	%	35.0	%
State, net of federal benefit	2.2	%	2.1	%	1.5	%
Impact of international operations	3.9	%	(4.8	)%	(9.5	)%
Stock-based compensation	1.8	%	0.6	%	—	%
Tax credits	(1.9	)%	0.1	%	(0.7	)%
Others	(0.4	)%	0.1	%	0.1	%
Provision for income taxes	40.6	%	33.1	%	26.4	%

Income tax benefits in the amount of $0.4 million, $1.1 million and $3.5 million related to stock options were credited to additional paid-in capital during the years ended December 31, 2013, 2012, and 2011, respectively. As a result of changes in fair value of available for sale securities, income tax benefit of $16,000, tax expense of $5,000 and $8,000 was recorded in comprehensive income related to the years ended December 31, 2013, 2012, and 2011, respectively.

As of December 31, 2013, the Company has approximately $20.2 million and $0.1 million of acquired federal and state net operating loss carry forwards as well as $0.7 million of California tax credits carryforwards. All of these losses and $0.1 million of these credits are subject to annual usage limitations under Internal Revenue Code Section 382. The federal losses expire in different years beginning in fiscal 2021. The state loss begins to expire in fiscal 2015. The state tax credit carryforwards have no expiration.

The Company files income tax returns in the U.S. federal jurisdiction and various state, local, and foreign jurisdictions. With few exceptions, the Company is no longer subject to U.S. federal, state, local, or foreign income tax examinations for years before 2008. In 2011, the US federal Internal Revenue Service (IRS) commenced an audit of the Company's 2008 and 2009 tax years. The audit was completed in October 2012, and all issues under examination by the IRS were effectively settled. In November, 2012, the Italian Tax Authority (ITA) commenced an audit of the Company’s 2004 through 2011 tax years, and has subsequently extended audit procedures to include the 2012 tax year. The Company has limited audit activity in various states and other foreign jurisdictions. Due to the uncertain nature of ongoing tax audits, the Company has recorded its liability for uncertain tax positions as part of its long-term liability as payments cannot be anticipated over the next 12 months. The existing tax positions of the Company continue to generate an increase in the liability for uncertain tax positions. The liability for uncertain tax positions may be reduced for liabilities that are settled with taxing authorities or on which the statute of limitations could expire without assessment from tax authorities. The possible reduction in liabilities for uncertain tax positions resulting from the expiration of statutes of limitation in multiple jurisdictions in the next 12 months is approximately $2.8 million, excluding the interest, penalties and the effect of any related deferred tax assets or liabilities.

A reconciliation of the beginning and ending amount of gross unrecognized tax benefits ("UTB") is as follows (in thousands):

	Federal, State, and Foreign Tax	
Gross UTB Balance at December 31, 2010	$18,432	
Additions based on tax positions related to the current year	1,795	
Additions for tax positions of prior years	1,015	
Settlements	(179	)
Reductions for tax positions of prior years	(2	)
Reductions due to lapse of applicable statutes	(3,699	)
Adjustments due to foreign exchange rate movement	(27	)
Gross UTB Balance at December 31, 2011	17,335	
Additions based on tax positions related to the current year	711	
Additions for tax positions of prior years	956	
Settlements	(2,620	)
Reductions for tax positions of prior years	(3,590	)
Reductions due to lapse of applicable statutes	(449	)
Adjustments due to foreign exchange rate movement	(4	)
Gross UTB Balance at December 31, 2012	12,339	
Additions based on tax positions related to the current year	1,866	
Additions for tax positions of prior years	4,106	
Settlements	(3,134	)
Reductions for tax positions of prior years	(1,163	)
Reductions due to lapse of applicable statutes	(1,314	)
Adjustments due to foreign exchange rate movement	43	
Gross UTB Balance at December 31, 2013	$12,743	

The total amount of net UTB that, if recognized would affect the effective tax rate as of December 31, 2013 is $11.8 million. The ending net UTB results from adjusting the gross balance at December 31, 2013 for items such as U.S. federal and state deferred tax, foreign tax credits, interest, and deductible taxes. The net UTB is included as a component of non-current income taxes payable within the consolidated balance sheet.

The Company recognizes interest and penalties accrued related to unrecognized tax benefits in income tax expense. During the years ended December 31, 2013, 2012, and 2011, total interest and penalties expensed were $446,000, $74,000 and $30,000, respectively. As of December 31, 2013 and December 31, 2012, accrued interest and penalties on a gross basis was $2.1 million and $1.8 million, respectively. Included in accrued interest are amounts related to tax positions for which the ultimate deductibility is highly certain but for which there is uncertainty about the timing of such deductibility. Because of the impact of deferred tax accounting, other than interest, the impact of any uncertain tax benefits related to temporary differences would not affect the annual effective tax rate but would accelerate the payment of cash to the taxing authority to an earlier period.

With the exception of those foreign sales subsidiaries for which deferred tax has been provided, the Company intends to indefinitely reinvest foreign earnings. These earnings were approximately $60.5 million and $63.4 million as of December 31, 2013 and December 31, 2012, respectively. Because of the availability of U.S. foreign tax credits, it is not practicable to determine the income tax liability that would be payable if such earnings were not indefinitely reinvested.

Note 9. Commitments and Contingencies

Leases

The Company leases office space, cars and equipment under non-cancelable operating leases with various expiration dates through December 2026. Rent expense in the years ended, December 31, 2013, 2012, and 2011 was $9.9 million, $7.6 million and $7.0 million, respectively. The terms of some of the Company’s office leases provide for rental payments on a graduated scale. The Company recognizes rent expense on a straight-line basis over the lease period, and has accrued for rent expense incurred but not paid.

Future minimum lease payments under non-cancelable operating leases are as follows (in thousands):

Year Ending December 31,	
2014	$2,987
2015	9,242
2016	6,005
2017	5,028
2018	4,697
Thereafter	5,990
Total minimum lease payments	$33,949

Employment Agreements

The Company has signed various employment agreements with key executives pursuant to which, if their employment is terminated without cause, such employees are entitled to receive their base salary (and commission or bonus, as applicable) for 52 weeks (for the Chief Executive Officer), 39 weeks (for the Senior Vice President of Worldwide Operations and Support) and up to 26 weeks (for other key executives). Such employees will also continue to have stock options vest for up to a one-year period following such termination without cause. If a termination without cause or resignation for good reason occurs within one year of a change in control, such employees are entitled to full acceleration (for the Chief Executive Officer) and up to two years acceleration (for other key executives) of any unvested portion of his or her equity awards.

Purchase Obligations

The Company has entered into various inventory-related purchase agreements with suppliers. Generally, under these agreements, 50% of orders are cancelable by giving notice 46 to 60 days prior to the expected shipment date and 25% of orders are cancelable by giving notice 31 to 45 days prior to the expected shipment date. Orders are non-cancelable within 30 days prior to the expected shipment date. At December 31, 2013, the Company had $187.3 million in non-cancelable purchase commitments with suppliers. The Company establishes a loss liability for all products it does not expect to sell for which it has committed purchases from suppliers. Such losses have not been material to date.

Guarantees and Indemnifications

The Company, as permitted under Delaware law and in accordance with its Bylaws, indemnifies its officers and directors for certain events or occurrences, subject to certain limits, while the officer or director is or was serving at the Company’s request in such capacity. The term of the indemnification period is for the officer’s or director’s lifetime. The maximum amount of potential future indemnification is unlimited; however, the Company has a Director and Officer Insurance Policy that limits its exposure and enables it to recover a portion of any future amounts paid. As a result of its insurance policy coverage, the Company believes the fair value of these indemnification agreements is minimal. Accordingly, the Company has no liabilities recorded for these agreements as of December 31, 2013.

In its sales agreements, the Company typically agrees to indemnify its direct customers, distributors and resellers for any expenses or liability resulting from claimed infringements of patents, trademarks or copyrights of third parties.

The terms of these indemnification agreements are generally perpetual any time after execution of the agreement. The maximum amount of potential future indemnification is unlimited. The Company believes the estimated fair value of these agreements is minimal. Accordingly, the Company has no liabilities recorded for these agreements as of December 31, 2013.

Litigation and Other Legal Matters

The Company is involved in disputes, litigation, and other legal actions, including, but not limited to, the matters described below. In all cases, at each reporting period, the Company evaluates whether or not a potential loss amount or a potential range of loss is probable and reasonably estimable under the provisions of the authoritative guidance that addresses accounting for contingencies. In such cases, the Company accrues for the amount, or if a range, the Company accrues the low end of the range as a component of legal expense in litigation reserves. The Company monitors developments in these legal matters that could affect the estimate the Company had previously accrued. In relation to such matters, the Company currently believes that there are no existing claims or proceedings that are likely to have a material adverse effect on its financial position within the next twelve months, or the outcome of these matters is currently not determinable. There are many uncertainties associated with any litigation, and these actions or other third-party claims against the Company may cause the Company to incur costly litigation and/or substantial settlement charges. In addition, the resolution of any intellectual property litigation may require the Company to make royalty payments, which could have an adverse effect in future periods. If any of those events were to occur, the Company's business, financial condition, results of operations, and cash flows could be adversely affected. The actual liability in any such matters may be materially different from the Company's estimates, which could result in the need to adjust the liability and record additional expenses.

Ruckus Wireless v. NETGEAR Inc.

On May 5, 2008, a lawsuit was filed against the Company by Ruckus Wireless (“Ruckus”), a developer of Wi-Fi technology, in the U.S. District Court, Northern District of California (case number C08-2310-PJH (“NETGEAR I”)). Ruckus alleges that the Company infringes U.S. Patent Nos. 7,358,912 ("the '912 Patent") and 7,193,562 ("the '562 Patent") in the course of deploying Wi-Fi antenna array technology in its WPN824 RangeMax wireless router. Ruckus also sued Rayspan Corporation alleging similar claims of patent infringement. The Company filed its answer to the lawsuit in the third quarter of 2008. The Company and Rayspan Corporation jointly filed a request for inter partes reexamination of the Ruckus patents with the USPTO on September 4, 2008. The Court issued a stay of the litigation while the reexaminations proceeded in the USPTO. On November 28, 2008, a reexamination was ordered with respect to claims 11-17 of the '562 Patent, but denied with respect to claims 1-10 and 18-36. On December 17, 2008, the defendants jointly filed a petition to challenge the denial of reexamination of claims 1-10 and 18-36 of the '562 Patent. In July 2009, the petition was denied, and the remaining claims 11-17 were confirmed by the USPTO. On December 2, 2008, reexamination was granted with regard to the '912 Patent. In early October 2009, the Company received an Action Closing Prosecution in the reexamination of the '912 Patent. All the claims of the '912 Patent, with the exception of the unchallenged claims 7 and 8, were finally rejected by the USPTO. On October 30, 2009, Ruckus submitted an “after-final” amendment in the '912 Patent reexamination proceeding. The Company's comments to Ruckus' “after-final” amendment were submitted on November 30, 2009. On December 1, 2009, the Court found that bifurcating the '562 Patent from the '912 Patent and commencing litigation on the '562 Patent while the USPTO reexamination process and appeals are still pending would be an inefficient use of the Court's resources. Accordingly, the Court ruled that the litigation stay should remain in effect. On September 12, 2010, the Company filed the rebuttal brief in its appeals of the USPTO's rulings during the reexamination of the '562 Patent, and the Company requested an oral hearing with the Board of Appeals at the USPTO to discuss this brief. On September 13, 2010, Ruckus filed a notice of appeal of the '912 Patent to appeal the adverse rulings it received from the USPTO in the reexamination of this patent. The Company filed a respondent's brief in the '912 Patent case on January 24, 2011. An oral hearing in the '562 case was set for February 1, 2011, but the Company decided to cancel it and let the USPTO decide the '562 case based solely on the previously submitted papers. On May 13, 2011, the USPTO indicated that the Company was successful in its appeal of the examiner's previous decision to allow claims 11-17 in the '562 reexamination, and the USPTO Board of Appeals reversed the examiner's decision and declared those claims invalid. On June 13, 2011, Ruckus submitted a request for rehearing by the Board of Appeals of its decision to reject claims 11-17 of the '562 Patent. On September 28, 2011, the Board of Patent Appeals and Interferences denied Ruckus's request for a rehearing in the '562 Patent reexamination case. Ruckus did not timely file a notice of appeal to the Court of Appeals for the Federal Circuit appealing the USPTO's cancellation of claims 11-17 of the '562 patent. Therefore, a reexamination certificate will issue with claims 11-17 cancelled and claims 1-10 and 18-36 confirmed.

On November 4, 2009, Ruckus filed a complaint in the U.S. District Court, Northern District of California (case number C09-5271-PJH (“NETGEAR II”)), alleging the Company and Rayspan Corporation infringed a patent that is related to the patents previously asserted against the Company and Rayspan Corporation by Ruckus, as discussed above. The asserted patent in the second case was U.S. Patent No. 7,525,486 entitled “Increased wireless coverage patterns.” As with the previous Ruckus action, the WPN824 RangeMax wireless router was the alleged infringing device. The Company challenged the sufficiency of Ruckus's complaint and moved to dismiss the complaint. Ruckus opposed this motion. The Court partially agreed with the Company's motion and ordered Ruckus to submit a new complaint, which Ruckus did. The initial case management conference occurred on February 11, 2010. On March 25, 2010, the Court ordered a stay until the completion of the reexamination proceedings instigated on the patents in NETGEAR I.

Ruckus and the Company in December 2012 requested that the stay of the California actions be lifted. This request to lift the stay was predicated on Ruckus's Withdrawal of Appeal and Cancellation of Claims ("Withdrawal") of the '912 Patent that was

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on appeal in re-examination at the USPTO and that was asserted by Ruckus in NETGEAR I. Through the filing of the Withdrawal, Ruckus announced its intent to withdraw and its actual withdrawal of its appeal of claims 1, 4-9-14, 18, 19, and 22-29 in re-examination (the "Appealed Claims"), and Ruckus further announced its intent to cancel and its actual cancellation of claims 30-31 in re-examination (the "Cancelled Claims"). Claims 2, 3, 15-17, 20, and 21 had previously been cancelled during re-examination (the "Previously Cancelled Claims"). Because the Appealed Claims and the Cancelled Claims represented the entirety of the claims remaining for consideration in re-examination, and the Previously Cancelled Claims are no longer of record in the offensive case by Ruckus against the Company, there are no remaining claims for re-examination in the '912 Patent and the '912 Patent cannot be asserted against the Company. Thus, the Company and Ruckus requested that the Court lift the stay of this litigation and calendar a case management conference. The case management conference occurred on January 3, 2013. At that time, the Court scheduled a claim construction hearing for August 2013. The parties to the lawsuit - the Company, Rayspan, and Ruckus - also agreed that Ruckus's two offensive cases against the Company and Rayspan should be consolidated because the cases involve similar complaints and common questions of law and fact and doing so would advance the interests of judicial economy.

Ruckus served its infringement contentions on the Company on January 17, 2013, and the Company's invalidity contentions were served on Ruckus on March 4, 2013. On March 5, 2013, Ruckus and Rayspan filed a stipulation with proposed order dismissing Rayspan from the case, and, on March 6, 2013, the Court dismissed with prejudice Rayspan. On March 14, 2013, Ruckus filed its Second Amended Complaint, as ordered by the Court. Ruckus did not add any patents, but attempted to add claims of breach of contract and misappropriation of trade secrets by the Company. The Company believed that Ruckus contravened the Court's order that there should not be a “substantial change” in the Second Amended Complaint by adding the breach of contract and misappropriation of trade secrets claims to the lawsuit. Consequently, the Company filed a Motion to Strike the newly added claims. On May 22, 2013, the Court granted the Company's motion to strike the state law claims of trade secret misappropriation and breach of contract from the Second Amended Complaint. On June 10, 2013, Ruckus filed its Motion for Leave to Amend and File its Third Amended Complaint, adding back the trade secret misappropriation and breach of contract claim. The Company responded on June 24, 2013, and the parties orally argued the motion and response on July 24, 2013. On July 29, 2013, the Court denied Ruckus's Motion for Leave to Amend and File its Third Amended Complaint, meaning the Court would not allow Ruckus to bring its breach of contract claims or trade secret misappropriation claims because they were time barred.

In May 2013, the parties filed their Joint Claim Construction Statement where the parties indicated to the Court the disputed claim language, the parties' competing constructions, and the evidence in support of the parties' positions. Ruckus then filed its opening claim construction brief on June 18, 2013 and the Company filed its reply on July 1, 2013. The parties gave a claim construction tutorial to the Court on August 16, 2013, and, on August 28, 2013, the parties argued their proposed claim constructions before the Court. On December 16, 2013, the Court denied Ruckus’s attempt to strike the Company’s invalidity arguments and issued its claim construction order. On January 31, 2014, the Company and Ruckus entered into a settlement agreement that settled all outstanding litigation between the parties thereby concluding this litigation.

On November 19, 2010, the Company filed suit against Ruckus in the U.S. District Court, District of Delaware for infringement of four of the Company's patents. The Company alleged that Ruckus's manufacture, use, sale or offers for sale within the United States or importation into the United States of products, including wireless communication products, infringed United States Patent Nos. 5,812,531, 6,621,454, 7,263,143, and 5,507,035, all owned by the Company. The Company granted Ruckus an extension to file its answer to the Company's suit, and on January 11, 2011, Ruckus filed a motion to dismiss the Company's suit based on insufficient pleadings. The Company filed its response to Ruckus's motion on January 31, 2011. In addition, on May 6, 2011, Ruckus filed a motion to transfer venue to the Northern District of California. The Court denied Ruckus' motion to transfer the case to the Northern District of California and granted the Company leave to file an amended complaint rather than address the Ruckus motion to dismiss based on insufficient pleadings. The Company filed the proposed amended complaint. Nevertheless, Ruckus filed a second motion to dismiss based on insufficient pleadings by the Company. On March 28, 2012, the Delaware District Court in a memorandum opinion and order denied Ruckus's second motion to dismiss. A scheduling conference occurred April 18, 2012, and the Company submitted its initial disclosures in the case on May 15, 2012. On May 31, 2012, Ruckus filed its third motion to dismiss, asserting that the Company cannot sustain its indirect infringement and willfulness allegations without pleading pre-suit knowledge of the patents. The Company responded to Ruckus's motion to dismiss on June 18, 2012. The Court released the schedule for the case on June 8, 2012 with Claim Construction and Summary Judgment Hearings scheduled for August 9, 2013 and a ten day jury trial scheduled for October 21, 2013. On July 13, 2012, the Company added to its complaint against Ruckus an allegation of infringement of patent number 6,512,480 (“System and method for narrow beam antenna diversity in an RF data transmission system”) by Ruckus's ZoneFlex and MediaFlex products. The Company and Ruckus participated in a court-ordered mediation on September 13, 2012 in Delaware, and the parties did not come to an agreement to settle the litigation pending between the parties. Fact discovery closed on December 14, 2012 and expert discovery also closed. In addition, all claim construction and summary judgment briefing was finished. On August 9, 2013 the parties argued their claim construction and summary judgment briefing before the Court. On September 30, 2013, the Court dismissed the asserted claims of three of the Company’s five patents in suit because the Court agreed with Ruckus's summary judgment motions that the claims were indefinite. The Court also released its claim construction rulings the same day. As a result of the Court's rulings, two patents (6,631,454 and 7,263,143) and five claims remained standing against Ruckus for the trial that began on October 22, 2013 and ended on October 31, 2013. At the conclusion of the trial, a jury rendered a verdict that the two patent and five claims were not infringed by Ruckus, as the Company had contended, and that the patents were not invalid, as Ruckus has contended. On January 31, 2014, the Company and Ruckus entered into a settlement agreement that settled all outstanding litigation between the parties thereby concluding this litigation.

On June 19, 2013, Ruckus filed a complaint in Delaware accusing NETGEAR of infringing United States Patent No. 8,031,129 ("the '129 Patent") and United States Patent No. 8,150,470 ("the '470 Patent"). Ruckus accused the Company of infringing the '129 Patent by making, using, offering to sell, selling, and/or importing products, such as the Company's N600 Wireless Dual Band Routers (WNDR3400). Ruckus also accused the Company of knowingly and actively inducing infringement of the '129 Patent. Ruckus accused the Company of infringing the '470 Patent by making, using, offering to sell, selling, and/or importing products, such as NETGEAR's N600 Wireless Dual Band Gigabit Routers (WNDR3800). Ruckus also accused the Company of knowingly and actively inducing infringement of the '470 Patent. On August 26, 2013, Ruckus filed an amended complaint that dropped its claims of induced and willful infringement that were in the original complaint. The Company filed its answer to Ruckus's complaint on October 15, 2013, and asserted that Ruckus's patents were invalid and not infringed by the Company. On January 31, 2014, the Company and Ruckus entered into a settlement agreement that settled all outstanding litigation between the parties thereby concluding this litigation.

The settlement did not have a material financial impact to the Company.

Northpeak Wireless, LLC v. NETGEAR, Inc.

In October 2008, a lawsuit was filed against the Company and 30 other companies by Northpeak Wireless, LLC ("Northpeak") in the U.S. District Court, Northern District of Alabama. Northpeak alleges that the Company's 802.11b compatible products infringe certain claims of U.S. Patent Nos. 4,977,577 ("the '577 Patent") and 5,987,058 ("the '058 Patent"). The Company filed its answer to the lawsuit in the fourth quarter of 2008. On January 21, 2009, the District Court granted a motion to transfer the case to the U.S. District Court, Northern District of California. In August 2009, the parties stipulated to a litigation stay pending a reexamination request to the USPTO on the asserted patents. The reexaminations of the patents are proceeding. In March 2011, the USPTO confirmed the validity of the asserted claims of the '577 Patent over certain prior art references. In April 2011, the USPTO issued a final office action rejecting both asserted claims of the '058 Patent as being obvious in light of the prior art. In March 2013, the Board of Patent Appeals and Interferences of the USPTO affirmed the rejection of both asserted claims of the '058 Patent. The case remains stayed by stipulation, and no trial date has been set. The Company does not expect there to be a material financial impact to the Company because of this litigation matter.

Ericsson v. NETGEAR, Inc.

On September 14, 2010, Ericsson Inc. and Telefonaktiebolaget LM Ericsson (collectively "Ericsson") filed a patent infringement lawsuit against the Company and defendants D-Link Corporation, D-Link Systems, Inc., Acer, Inc., Acer America Corporation, and Gateway, Inc. in the U.S. District Court, Eastern District of Texas alleging that the defendants infringe certain Ericsson patents. The Company has been accused of infringing eight U.S. patents: 5,790,516; 6,330,435; 6,424,625; 6,519,223; 6,772,215; 5,987,019; 6,466,568; and 5,771,468 ("the '468 Patent"). Ericsson generally alleges that the Company and the other defendants have infringed and continue to infringe the

Ericsson patents through the defendants' IEEE 802.11-compliant products. In addition, Ericsson alleged that the Company infringed the claimed methods and apparatuses of the '468 Patent through the Company's PCMCIA routers. The Company filed its answer to the Ericsson complaint on December 17, 2010 where it asserted the affirmative defenses of noninfringement and invalidity of the asserted patents. On March 1, 2011, the defendants filed a motion to transfer venue to the District Court for the Northern District of California and their memorandum of law in support thereof. On March 21, 2011, Ericsson filed its opposition to the motion, and on April 1, 2011, defendants filed their reply to Ericsson's opposition to the motion to transfer. On June 8, 2011, Ericsson filed an amended complaint that added Dell, Toshiba and Belkin as defendants. At the status conference held on Jun 9, 2011, the Court set a Markman hearing for June 28, 2012 and trial for June 3, 2013. On June 14, 2011, Ericsson submitted its infringement contentions against the Company. On September 29, 2011, the Court denied the defendants' motion to transfer venue to the Northern District of California. In advance of the Markman hearing, the parties on March 9, 2012 exchanged proposed constructions of claim terms and on April 9, 2012 filed the Joint Claim Construction Statement with the District Court. On May 8, 2012, Ericsson submitted its opening Markman brief and on June 1, 2012 the defendants submitted their responsive Markman brief. Ericsson's Reply Markman brief was submitted June 15, 2012, and on June 28, 2012 the Markman hearing was held in the Eastern District of Texas. On June 21, 2012, Ericsson dismissed the '468 Patent (“Multipurpose base station") with prejudice and gave the Company a covenant not to sue as to products in the marketplace now or in the past. On June 22, 2012, Intel filed its Complaint in Intervention, meaning that Intel became an official defendant in the Ericsson case. The parties thereafter completed fact discovery and exchanged expert reports. During the exchange of the expert reports, Ericsson dropped the '516 patent (the OFDM "pulse shaping" patent). In addition, Ericsson dropped the '223 Patent (packet discard patent) against all the defendants' products, except for those products that use Intel chips. Thus, Ericsson has now dropped the '468 Patent (wireless base station), the '516 Patent (OFDM pulse shaping), and the '223 Patent (packet discard patent) for all non-Intel products. The five remaining patents are all only asserted against 802.11-compliant products.

At a Court ordered mediation in Dallas on January 15, 2013, the parties did not come to an agreement to settle the litigation. On March 8, 2013, the parties received the Markman (claim construction) Order in response to the claim construction briefing and claim construction hearing.

A jury trial in the Ericsson case occurred in the Eastern District of Texas from June 3 through June 13, 2013. After hearing the evidence, the jury found no infringement of the '435 and '223 patents, and the jury found infringement of claim 1 of the '625 patent, claims 1 and 5 of the '568 patent, and claims 1 and 2 of the '215 patent. The jury also found that there was no willful infringement by any defendant. Additionally, the jury found no invalidity of the asserted claims of the '435 and '625 patents. The jury assessed the following damages against the defendants: D-Link: $435,000; NETGEAR: $3,555,000; Acer/Gateway: $1,170,000; Dell: $1,920,000; Toshiba: $2,445,000; Belkin: $600,000. The damages awards equate to 15 cents per unit for each accused 802.11 device sold by each defendant. Thus, unless the defendants' various appeals are successful, the Company will likely have a 15 cent per unit obligation on its 802.11 devices until 2016 (when one infringed patent in suit expires), 10 cent per unit obligation from 2016 through 2018 (when a second infringed patent in suit expires), and a 5 cent per unit obligation from 2018 through 2020 (when the third and last infringed patent in suit expires).

The Company and other defendants submitted various post-trial motions and briefs to the Court for its consideration, including motions and briefs for judgment as a matter of law in favor of defendants on non-infringement and invalidity of the patents in suit and for a reduction in damages, and the defendants have also moved for a new trial. These motions were argued before the Court on July 16, 2013. On August 6, 2013, the Court issued its orders on the various JMOL's ("Judgment as a Matter of Law") and other post-trial motions. The Court denied all the defendants' motions and set the reasonable and nondiscriminatory (RAND) royalty rate for the infringed patents equivalent to the jury verdict of 15 cents per unit.

After negotiations, Ericsson and the Company agreed to the following as collateral while the appeal of the verdict, Court's rulings, and the RAND royalty rate are pending. Ericsson will forego collecting the $3,555,000 verdict plus various fees (Prejudgment interest of $224,141; Post-judgment interest of $336 per day; Costs of $41,667) assigned to the Company pending appeal, so long as a Company representative declares and provides Ericsson with adequate quarterly assurances that the judgment can still be paid. For the ongoing royalties of 15 cents per 802.11n or 802.11ac device sold by the company that the jury and Court awarded, the Company will place the ongoing royalty amount into the Court's registry (escrow account) and will give Ericsson a corresponding royalty report until the Company's appeals of the jury verdict, the Court's orders, and the RAND royalty rate are exhausted.

On December 16, 2013, the defendants submitted their appeal brief to the Federal Circuit. Ericsson's reply brief is due on February 20, 2014. The defendants estimate that the appeals process will take about 18 months from the jury's verdict to run its course. The Company accrued and expensed the $3,555,000 in damages during the second quarter of 2013 to satisfy the verdict.

NETGEAR, Inc. v. Innovatio IP Ventures LLC.

On November 16, 2011, the Company filed a declaratory judgment action in the District of Delaware for non-infringement and invalidity of 17 WiFi-related patents brought in the approximately 15 actions throughout the United States by Innovatio IP Ventures LLC (“Innovatio”) against end user customers of the Company and other companies. Shortly after filing the declaratory judgment action, the Company filed a response supporting Cisco Systems, Inc.'s ("Cisco") and Motorola Solutions, Inc.'s ("Motorola") Motion to Transfer for Coordinated Pretrial Proceedings Pursuant to 28 U.S.C. § 1407 that was before the United States Judicial Panel on Multidistrict Litigation (“JPML”). On December 28, 2011, the JPML issued an order transferring the Innovatio actions throughout the United States, including the Company's declaratory judgment action, to the United States District Court for the Northern District of Illinois. Thus, the Company's declaratory judgment action and approximately 15 other similar cases will now proceed in the Northern District of Illinois in a consolidated fashion. On July 10, 2012, Innovatio answered the Declaratory Judgment Complaint filed by the Company with various counterclaims, cross claims, and affirmative defenses. In its answer, Innovatio accused the Company of infringing six WiFi-related patents in addition to the 17 WiFi-related patents on which the Company brought its declaratory judgment action of non-infringement and invalidity. The Company filed its answer to

Innovatio's various counterclaims, cross claims, and affirmative defenses on August 3, 2012. In addition, on October 1, 2012, Cisco, Motorola and the Company filed an amended complaint alleging racketeering, fraud, interference with contract, unfair business practices, and conspiracy, among other things, against Innovatio. On February 4, 2013, the Court dismissed the offensive claims of Cisco, Motorola, and the Company that alleged Innovatio was engaging in racketeering, fraud, and unfair business practices by demanding licensing fees from hotels, cafes and other businesses but left intact claims against Innovatio that allege breach of contract with respect to Innovatio's fair, reasonable, and nondiscriminatory (FRAND) royalty obligations. The parties have already exchanged their Final Infringement, Unenforceability and Invalidity Contentions and Damages contentions.

The Court has implemented special damages-focused proceedings prior to proceeding to the liability or infringement phase of the case. Accordingly, the parties on July 18 and July 19, 2013 participated in a bench trial on essentiality. Because the plaintiff and defendants disagree as to whether approximately 230 patent claims asserted by Innovatio are essential to practicing the 802.11 standard, this bench trial was held to determine whether those claims are essential. Essential claims are subject to FRAND royalty obligations, and such royalty obligations are generally subject to lower rates than Innovatio is currently demanding from the parties it is accusing of infringing its patents. On July 26, 2013, the Court issued an order deeming all claim essential. The Court reviewed various arguments on the IEEE's definition of “Essential Patent Claims” and found that essential patent claims are those which are necessary to implement mandatory or optional features but also can cover items not explicitly required by the standard -- either “enabling” technologies or items that are technically and commercially necessary to implement the standard. The Court confirmed its previous holding that the prospective licensee has the burden of proving essentiality, and that the analysis should be performed on a claim by claim basis, as opposed to a patent by patent basis. The Court then held a bench trial, which began on September 9, 2013, and ended on September 19, 2013, to determine what the FRAND royalty rate would be on the patents and claims earlier found to be essential by the Court. The Court ruled on September 25, 2013 that the FRAND royalty for Innovatio's standard-essential Wi-Fi patents would be 9.56 cents per unit, far lower than the several dollars per unit that Innovatio had sought. Innovatio’s method would have valued the patents at rates ranging from $3.39 per unit for a wireless router to $16.17 per unit for a tablet. The Court also determined that the correct royalty base for making a FRAND determination is the price of the Wi-Fi chip embedded in each product, finding the patents made up a small part of the value of the chip. Innovatio had said the rate should be based on the selling price for accused products, which could run to hundreds of dollars and lead to royalties of many dollars per unit. The Court concluded that Innovatio's expert witnesses presented "no legally sound and factually credible method" for calculating the FRAND rate based on the price of the whole product, leaving it no choice but to base its analysis on the price of the chip.

On November 22, 2013, during a court-ordered mediation, Innovatio and the Company agreed to settle the case for a payment from the Company to Innovatio in return for a fully-paid-up license to the patents in suit, their foreign counterparts, and any other patents that Innovatio currently holds. The settlement did not have a material financial impact to the Company.

U.S. Ethernet Innovation, LLC v. NETGEAR, Inc.

On June 22, 2012, U.S. Ethernet Innovations, LLC (“USEI”) sued the Company in the District Court for the Eastern District of Texas, alleging infringement of certain of its Ethernet-related patents: U.S. Patent Numbers 5,732,094 (“Method for automatic initiation of data transmission”); 5,434,872 (“Apparatus for automatic initiation of data transmission”); 5,299,313 (“Network interface with host independent buffer management”) and 5,530,874 (“Network adapter with an indication signal mask and an interrupt signal mask”). USEI is a patent holding entity with a nominal office in the Eastern District of Texas. The accused products include products such as the “Netgear RT311 Internet Gateway Router.” The Company received an extension until August 17, 2012 to answer the complaint. USEI has sued, in addition to the Company, the following companies on the same and other of its Ethernet-related patents: Ricoh Americas Corporation, TRENDnet, Inc., Xerox Corporation, Konica Minolta Business Solutions U.S.A., Inc., Freescale Semiconductor, Inc., Sharp Electronics Corporation, Digi International Inc., NetSilicon, Inc., Epson America, Inc., Cirrus Logic, Inc., Yamaha Corporation of America, Control4 Corporation, Samsung Electronics Co., Ltd., Samsung Electronics America, Inc., Samsung Telecommunications America, LLC, Samsung Austin Semiconductor, LLC, Oki Data Americas, Inc., STMicroelectronics N.V., and STMicroelectronics, Inc. (collectively, “Defendants”).

The Company received a further extension to answer the complaint and answered on September 4, 2012 via a 12(b)(6) motion to dismiss the complaint for various reasons, including a lack of pleading specificity. USEI responded to the Company's motion to dismiss under Rule 12(b)(6) on September 21, 2012. The Company submitted its Reply in Support of its Motion to Dismiss on October 1, 2012.

USEI served its infringement contentions on the Company on October 10, 2012. The Company filed its transfer motion for a transfer to the Northern District of California and supporting declarations on November 16, 2012. On December 3, 2012, Defendants filed their joint invalidity contentions.

Because the Eastern District of Texas's preferred time for deciding motions to transfer is after the Markman hearing, the defendants filed a motion to stay the litigation pending the result of the Eastern District of Texas's decisions on the motion to transfer on January 29, 2013.

The Court has consolidated for discovery purposes USEI's cases against the aforementioned defendants and scheduled a consolidated Markman hearing for April 4, 2013 for the asserted patents. The Court also indicated that the court would consider any of Defendants' transfer motions as soon as possible.

On March 27, 2013, the Court issued a Memorandum Opinion and Order granting the Company's motion to transfer to the United States District Court for the Northern District of California, effective on April 16, 2013. In response, on April, 12, 2013, USEI filed a motion for clarification and/or reconsideration of the venue order. Specifically, USEI seeks to delay the transfer until the Markman order in the Eastern District of Texas case becomes final under the guise that it is more efficient to allow the Texas court to construe the terms. The Company opposed USEI's motion. The mediation in this case that was scheduled for May 15, 2013 was cancelled.

On May 16, 2013, the Court in the Eastern District of Texas denied USEI's motion to reconsider the timing of transfer. Also, the Court sent notice that the Eastern District of Texas case is closed, and instructed the clerk to transfer the case immediately.

On June 28, 2013, the new Court in the case of USEI against the Company (the District Court for the Northern District of California), held a combined Case Management Conference for the Company's newly transferred case and the case USEI has previously instigated against several other defendants, including several Ethernet chip manufacturers. At this Case Management Conference, the Court commented that the chip manufacturers should go to trial first. The Court also ruled that the Company is going to join on the same schedule as the other defendants and allowed the Company to file a new motion to dismiss with the citation of supplemental Northern District of California authority.

One additional patent is asserted against the Company that is not asserted against the other Northern District of California defendants (the '874 Patent). The Court agreed that, if USEI and the Company cannot resolve '874 Patent claim construction issues, the Court will build in dates to the litigation schedule for doing so (i.e. a limited claim construction hearing on terms of the '874 Patent).

In July 2013, the Company filed a new motion to dismiss, as specifically allowed by the Court at the initial case management conference in the Northern District of California. On August 12, 2013, the Court granted the Company's motion to dismiss, but the Court granted USEI leave to amend its complaint. On August 26, 2013, USEI submitted its Amended Complaint, and on September 9, 2013, the Company filed its Answer and Counterclaims of noninfringement and invalidity of the patents in suit.

On November 12, 2013, during a court ordered mediation, USEI and the Company agreed to settle the case for a payment from the Company to USEI in return for a fully-paid-up license to the patents in suit, their foreign counterparts, and any other patents that USEI currently holds. The settlement did not have a material financial impact to the Company.

ReefEdge Networks, LLC v. NETGEAR, Inc.

On September 17, 2012, the Company was sued by ReefEdge Networks, LLC, a non-practicing entity. The Company received an extension from the plaintiff until November 8, 2012 to answer the complaint and answered the complaint on that date.

The complaint alleges that NETGEAR infringes three related patents: 6,633,761 B1; 6,975,864 B2; 7,197,308 B2. In general terms, these asserted patents involve seamlessly handing-off portable wireless devices from one access point to another so as to provide roaming within a wireless network.

The complaint specifically accuses the Company's ProSafe wireless controller of infringing these three patents. On August 15, 2012, ReefEdge filed complaints in Delaware against Aruba Networks Inc., Cisco Systems Inc., Meru Networks Inc., and Ruckus Wireless Inc. alleging infringement of the same three patents. In the second tranche of lawsuits, ReefEdge sued--in addition to the Company-Brocade Communications Systems, Inc., Extreme Networks Inc., ADTRAN, Inc., Alcatel-Lucent Inc., D-Link Systems, Inc., Enterasys Networks, Inc., Motorola Solutions Inc., CDW Corporation, Avaya Inc., and ZyXEL Communications Corporation. The Company has hired defense counsel and is evaluating ReefEdge's allegations. During the third quarter of 2013, the Company submitted its initial disclosures to ReefEdge and also produced its core technical documents to ReefEdge. Discovery is ongoing. It is too early to reasonably estimate any financial impact to the Company because of this litigation matter.

Pragmatus Telecom, LLC v. NETGEAR, Inc.

On December 6, 2012, Pragmatus Telecom, LLC (“Pragmatus”), filed a lawsuit against the Company asserting that the Company's use of a system “to provide live chat service over the Internet” infringes U.S. Patent Nos. 6,311,231, 6,668,286, and 7,159,043 ("'231 patent", "'286 patent", and "'043 patent", respectively).

The '231 patent is entitled "Method and System for Coordinating Data and Voice Communications via Customer Contact,” the '286 patent is entitled "Method and System for Coordinating Data and Voice Communications via Customer Contact Channel Changing System Over IP," and the '043 patent is entitled "Method and System for Coordinating Data and Voice Communications via Contact Channel Changing System," The patents very generally allegedly relate to “live chat" services of companies, which can give customers the ability to exchange text messages with a virtual or real customer support person. It appears that most companies named in the various lawsuits by Pragmatus license the “live chat” technology and software from a third-party supplier. A few of these third-party suppliers have been named in some of the over 100 lawsuits filed by Pragmatus in California, Delaware, and the Eastern District of Texas, and two third-party suppliers of text-chat (LivePerson and LogMeIn) have filed declaratory judgment actions on the patents in suit in Delaware. There is a pending reexamination on one of the three asserted patents.

Pragmatus and the Company agreed to extend the deadline for the Company to answer or otherwise respond to Pragmatus's complaint until February 11, 2013. The Company answered the complaint on that day by denying Pragmatus's infringement allegations and requesting a declaratory judgment by the Court that the patents in suit are not infringed and invalid. On February 20, 2013, the Company filed a motion to stay the case, and, on March 6, 2013, Pragmatus filed its opposition to the Company's motion to stay the case. The Company filed its reply on March 13, 2013. On May 14, 2013, the Court granted the Company's motion to stay “pending final exhaustion of all pending reexamination proceedings.” On June 22, 2013, both the '231 and '286 patents, which were the two asserted patents against the Company that were put into reexam by the defendants in a parallel Delaware action and the basis of the stay in the Pragmatus' case against the Company, emerged from reexam. In addition, the Delaware court lifted the stay in the Pragmatus cases pending in Delaware. The parties submitted a status report to the Court in January of 2014 indicating that: (1) the ‘231 Patent emerged from reexamination with all claims confirmed, and all rights of appeal have been exhausted; (2) the request for reexamination of the ‘043 Patent was denied; and (3) all claims of the ’286 patent were confirmed during reexamination, but the reexamination requestor appealed the examiner’s decision and the matter is now on appeal. The parties have asked the Court to lift the stay of the case and set a case management conference and an early neutral evaluation.

It is too early to reasonably estimate any financial impact to the Company because of this litigation matter.

Freeny v. NETGEAR, Inc.

On April 29, 2013, the Company and several other companies, including Apple, ASUSTek, Belkin, Buffalo, D-Link, IC Intracom, Ruckus, TP-Link, Vizio, and Western Digital, were sued in separate actions in the Eastern District of Texas by Charles C. Freeny III, Bryan E. Freeny, and James P. Freeny. The complaint alleges that dual-band wireless routers infringe U.S. Patent No. 7,110,744. The patent lists Charles Freeny as the inventor. Mr. Freeny's sons, Charles III and Bryan, now own the '744 patent, as Mr. Freeny is deceased. On June 21, 2013, the Company's answer and counterclaims were timely filed with the Court. The initial status conference was held on August 8, 2013. At the status conference, the Markman hearing was scheduled for August 7, 2014, and the trial date was set for April 6, 2015.

On August 2, 2013, Freeny produced its initial infringement contentions to the Company. The Company’s initial disclosures were given to Freeny on September 23, 2013, and, on October 10, 2013, the Company produced initial technical documents, as required by the Court’s local rules. Discovery is ongoing.

It is too early to reasonably estimate any financial impact to the Company because of this litigation matter.

Concinnitas v. NETGEAR, Inc.

On May 2, 2013, the Company was added to an existing case against Sierra Wireless America, Inc. and Sierra Wireless S.A. that was brought by Concinnitas, LLC and George W. Hindman in the Eastern District of Texas. The accused products will be the Company's Aircard products that it acquired from Sierra Wireless. On July 20, 2013, the Company's answer and counterclaims were timely filed with the Court. The Court set an initial scheduling conference for September 5, 2013, and at that conference the Court consolidated Concinnitas’s case against the Company with Concinnitas’s case against Samsung for discovery and claims construction purposes. Based on the date of the scheduling conference, Concinnitas’s infringement contentions were submitted on August 30, 2013, and the Company’s invalidity contentions and technical document production were submitted on October 17,

2013. On December 19, 2013, the Company and Concinnitas settled the lawsuit for a payment from the Company to Concinnitas. The settlement grants the Company a license to the patent in suit - US Patent 7,805,542 “Mobile Unit Attached in a Mobile Environment That Fully Restricts Access to Data Received Via Wireless Signal to a Separate Computer in the Mobile Environment” and two related patents - US Patent 6,324,592 “Apparatus and Method For a Mobile Computer Architecture and Input/Output Management Systems” and US Patent 7,165,123 “Apparatus and Method for I/O Management in a Mobile Environment Wherein Access to Data From a Wireless Signal is Restricted Based on a Persistent Unique Hardware Identification.” The settlement payment has been made, and did not have a material financial impact to the Company.

NETGEAR, Inc. v. ASUS

On July 22, 2013, the Company filed a complaint against ASUSTEK COMPUTER, INC. and ASUS COMPUTER INTERNATIONAL, INC. (collectively “ASUS”) seeking permanent injunctive relief, damages and declaratory relief for false advertising in violation of the Lanham Act, damages for tortious interference with the Company's prospective business relations, injunctive relief for unfair competition in violation of California Business and Professions Code, injunctive relief for false advertising pursuant to California Business and Professions Code, damages and injunctive relief pursuant the Sherman Antitrust Act, and various forms of declaratory relief.

The Company has asserted that contrary to ASUS's representations to the Federal Communications Commission (“FCC”), ASUS's wireless routers, including without limitation models RT-N65U and RT-AC66U, produce power outputs far in excess of those represented to the FCC, produce power outputs that exceed FCC maximum output levels, unlawfully cause interference with adjacent bandwidths (potentially including critically important navigation, communications, and safety devices), and operate in a manner that has never been accurately reported to the FCC. The Company contends that ASUS's representations that its RT-N65U and RT-AC66U wireless routers are FCC compliant are false, and are made with the intent to deceive potential consumers. The Company further contends that ASUS's misrepresentations regarding compliance of its wireless routers with the FCC regulations constitute unfair competition and false advertising, tortuously interfere with the Company's prospective business advantage, and have harmed the Company because the Company has lost expected sales due to such wrongful conduct and misrepresentations by ASUS.

After a series of extensions to answer the complaint granted by the Company to Asus, on September 3, 2013, Asus filed a motion to dismiss the complaint. Asus’s motion was generally based on the following arguments: a) the Company’s claims are preempted by FCC regulations; b) the Company is improperly seeking a private cause of action for violation of FCC regulations that create no such cause of action; c) the Company’s claims should be stayed or dismissed in deference to the primary jurisdiction of the FCC; and d) the Company fails to allege with sufficient specificity the nature of defendants' wrongful conduct nor how that conduct caused injury to the Company.

On October 7, 2013, the Company responded to Asus’s motion to dismiss by arguing that: a) the defendants violated unambiguous FCC regulations, thus, the Company's claims are in harmony, not conflict, with the FCC's regulatory goals; b) the Company’s damages arise not from defendants' private, regulatory dealings with the FCC, but rather from Asus’s conduct in the marketplace -- a realm regulated not by the FCC but by the courts; c) the Court should be allowed to adjudicate garden variety claims of false advertising, unfair competition, and deceptive trade practices that in no way implicate complex regulatory interpretations or policy judgments; and d) the complaint pleads facts in exacting detail.

On December 12, 2013, the Court refused to dismiss the Company’s antitrust and false advertising suit against Asus by denying Asus’s motion, thereby indicating that proceeding with the case would not violate the FCC’s authority.

Discovery in this case has commenced.

Spansion LLC v. NETGEAR, Inc.

On August 1, 2013, Spansion LLC ("Spansion") filed a section 337 complaint with the U.S. International Trade Commission ("ITC") naming: the Company; Belkin International, Inc. ("Belkin"); ASUSTek Computer Inc. and Asus Computer International (collectively, "Asus"); D-Link Corporation and D-Link System, Inc. (collectively, "D-Link"); Nintendo Co., Ltd. and Nintendo of America, Inc. (collectively, "Nintendo"); and Macronix America, Inc., Macronix Asia Limited, and Macronix (Hong Kong) Co., Ltd. (collectively "Macronix"), as proposed respondents. The Complaint is styled Certain Flash Memory Chips and Products Containing the Same. Spansion is seeking a general exclusion order, or in the alternative a limited exclusion order, as well as a cease and desist order.

Spansion has asserted six patents related to the manufacture, structure, and operation of flash memory cells, as well as security protection systems for flash memory devices:

- US Patent No. 6,369,416 “Semiconductor Device with Contacts Having a Sloped Profile
- US Patent No. 6,459,625 “Three Metal Process for Optimizing Layout Density”
- US Patent No. 6,731,536 “Password and Dynamic Protection of Flash Memory Data”
- US Patent No. 6,900,124 “Patterning for Elliptical Vss Contact on Flash Memory
- US Patent No. 7,018,922 “Patterning for Elongated Vss Contact on Flash Memory
- US Patent No. 7,151,027 “Method and Device for Reducing Interface Area of a Memory Device”

Four of the asserted patents, the '416, '625, '124, and '922 patents, were previously asserted by Spansion in the 337-TA-735 Investigation against Samsung, Apple, Nokia, PNY, RIM, and Transcend. ITC records indicate the 735 Investigation terminated based on settlement agreements prior to the hearing on the merits.

The accused products are identified as flash memory chips manufactured and sold by Macronix, as well as downstream products which contain the accused Macronix flash memory chips. The Complaint specifically identifies the Company WNR1000 wireless router, as an exemplary accused product, but makes clear that Spansion intends to expand the scope of accused products to include additional products, if any, which contain the accused Macronix flash memory chips.

In addition, on August 1, 2013, Spansion filed a parallel similar complaint against the same parties in the Northern District of California. Discovery in the ITC case has commenced and is ongoing, and the Northern District of California case has been stayed pending the outcome of the ITC case.

It is too early to reasonably estimate any financial impact to the Company because of this litigation matter.

Garnet Digital v. NETGEAR, Inc.

On September 9, 2013, the Company was sued in the Eastern District of Texas by a non-practicing entity named Garnet Digital (“Garnet”) that is based in Texas. There is one asserted patent, U.S. Pat. No. 5,379,421, which is directed to an interactive terminal for the access of remote database information. Garnet is alleging infringement by the Company by its products or systems, such as the NTV200, that are responsive to output signals from a telephone.

The patent has previously been litigated against Apple, Samsung, RIM, and a number of other wireless companies in Eastern Texas and the ITC. Garnet’s lawsuit against the Company is one of multiple cases filed by Garnet in the Eastern District of Texas Other defendants sued by Garnet in the Eastern District of Texas include: Boxee, D-Link Systems, Logitech, Roku, TiVo, DirecTV, DISH Network, Verizon, AT&T, Comcast, Panasonic, Western Digital, Pioneer, Yamaha, Denon, D&M Holdings, Marantz, and Onkyo. The Company answered the complaint on December 9, 2013 by asserting various affirmative defenses. In February of 2014, the court consolidated the Company’s case with the other pending Garnet Digital cases in the Eastern District of Texas, but the Court has not yet set a scheduling conference.

It is too early to reasonably estimate any financial impact to the Company because of this litigation matter.

Penovia LLC v. NETGEAR, Inc.

On September 27, 2013, a non-practicing entity named Penovia LLC (“Penovia”) filed suit against the Company in the Eastern District of Texas. Penovia asserts the Company’s wireless routers infringe U.S. Patent No. 5,822,221 (the “’221 patent”), entitled “Office Machine Monitoring Device.” Penovia’s complaint specifically names the DGN2000 Wireless-N product as an example of an infringing product. Penovia admits in the complaint that the ’221 patent expired on October 13, 2010, due to a lapse in maintenance fee payments. Consequently, Penovia seeks damages for an approximately three year period of time starting six years before the filing date of the complaint, September 27, 2007, and ending on October 13, 2010. Penovia has asserted the ’221 patent in 22 cases, all in the Eastern District of Texas. Penovia filed nine cases on May 21, 2013, and filed the remainder on September 27, 2013. The Company filed its answer on November 26, 2014 - asserting various affirmative defenses. On December 23, 2013 received Penovia’s infringement contentions.

It is too early to reasonably estimate any financial impact to the Company because of this litigation matter.

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Innovative Wireless Solutions LLC v. NETGEAR, Inc.

In November of 2013, Innovative Wireless Solutions filed a new wave of suits targeting 14 wireless router and networking companies, Adtran, Arris, Aruba Networks, Belkin, Buffalo Technology, Engenius Technologies, Fortinet, IC Intracom, Motorola Solutions, SMC Networks, Ubiquiti Networks, Western Digital, and Zoom Telephonics. Previously, in April of 2013, Innovative Wireless had filed 41 suits targeting hotels and restaurant chains over wireless Internet services. The Company was sued on November 6, 2013 in the District of Delaware.

The three patents-in-suit (5,912,895 entitled "Information network access apparatus and methods for communicating information packets via telephone lines" (the "'895 Patent"); 6,327,264 entitled "Information network access apparatus and methods for communicating information packets via telephone lines" (the "'264 Patent"); and 6,587,473 entitled "Information network access apparatus and methods for communicating information packets via telephone lines" (the "'473 Patent") originally were part of a portfolio of Nortel Networks' patents before they reached Innovative Wireless in March 2013.

The Company filed its answer on January 13, 2014, asserting various affirmative defenses. It is too early to reasonably estimate any financial impact to the Company because of this litigation matter.

IP Indemnification Claims

In its sales agreements, the Company typically agrees to indemnify its direct customers, distributors and resellers (the "Indemnified Parties") for any expenses or liability resulting from claimed infringements by the Company's products of patents, trademarks or copyrights of third parties that are asserted against the Indemnified Parties, subject to customary carve outs. The terms of these indemnification agreements are generally perpetual after execution of the agreement. The maximum amount of potential future indemnification is generally unlimited. From time to time, the Company receives requests for indemnity and may choose to assume the defense of such litigation asserted against the Indemnified Parties.

Environmental Regulation

The European Union ("EU") enacted the Waste Electrical and Electronic Equipment Directive, which makes producers of electrical goods, including home and commercial business networking products, financially responsible for specified collection, recycling, treatment and disposal of past and future covered products. The deadline for the individual member states of the EU to transpose the directive into law in their respective countries was August 13, 2004 (such legislation, together with the directive, the "WEEE Legislation"). Producers participating in the market were financially responsible for implementing these responsibilities under the WEEE Legislation beginning in August 13, 2005. The Company adopted the authoritative guidance for asset retirement and environmental obligations in the third quarter of fiscal 2005 and has determined that its effect did not have a material impact on the Company's consolidated results of operations and financial position for years ended December 31, 2013 and 2012. The WEEE Directive was recast on July 24, 2012, published on August 13, 2012, and was implemented by all member states on February 14, 2014. The Company expects no material impact on its consolidated results of operations and financial positions due to this recasting. Similar WEEE Legislation has been or may be enacted in other jurisdictions, including in the United States, Canada, Mexico, China, India, Australia and Japan. The Company continues to monitor WEEE Legislation and similar legislation in other jurisdictions as individual countries issue their implementation guidance. The Company believes it has met the applicable requirements of current WEEE Legislation and similar legislation in other jurisdictions, to the extent implementation requirements has been published.

Additionally, the EU enacted the Restriction of Hazardous Substances Directive (“RoHS Legislation”), the REACH Regulation, Packaging Directive and the Battery Directive. EU RoHS Legislation, along with similar legislation in China, requires manufacturers to ensure certain substances, including polybrominated biphenyls (“PBD”), polybrominated diphenyl ethers (“PBDE”), mercury, cadmium, hexavalent chromium and lead (except for allowed exempted materials and applications), are below specified maximum concentration values in certain products put on the market after July 1, 2006. The RoHS Directive was recast on July 21, 2011 and went into force on January 3, 2013. This did not have a material impact on the Company's consolidated results of operations and financial position. The REACH Regulation requires manufacturers to ensure the published lists of substances of very high concern in certain products are below specified maximum concentration values. The Battery Directive controls use of certain types of battery technology in certain products and requires mandatory marking. The Company believes it has met the requirements of the RoHS Directive Legislation, the REACH Regulation and the Battery Directive Legislation.

Additionally, the EU enacted the Energy Using Product (“EuP”) Directive, which came into force in August 2007. The EuP Directive required manufacturers of certain products to meet minimum energy efficiency performance requirements. These requirements were documented in EuP implementing measures issued for specific product categories. The implementing measures affecting the Company's products are minimum power supply efficiencies and may include required equipment standby modes, which also reduce energy consumption. The EuP Directive was repealed in November 2009 and replaced by the Energy Related Products ("ErP") Directive, which includes the same implementing measures of the former EuP Directive and new implementing measures applicable to the Company's products. The Company is in compliance with applicable implementing measures of the ErP Directives since it came into force.

Additionally, in 2010, the U. S. Congress passed the Dodd-Frank Wall Street Reform and Consumer Protection Act. Pursuant to Section 1502 of the Dodd-Frank Act, in August 2012, the U.S. Securities and Exchange Commission adopted Rule 13p-1 under the Securities Exchange Act of 1934, as amended. Rule 13p-1 is commonly known as the “Conflict Minerals Rule.” This rule is intended to address human rights violations arising from the forced labor, child labor, rape, murder and other hostilities related to mining operations in Africa, namely in the eastern Democratic Republic of the Congo (“DRC”) and nearby regions. This rule requires public companies to make disclosures regarding whether specified minerals in company products are sourced from the DRC or its surrounding countries (covered countries) in an effort to encourage companies to obtain these minerals from sources that do not directly or indirectly finance or benefit armed groups operating in these countries. The specified minerals, referred to as conflict minerals, are Tin, Tungsten, Tantalum and Gold, which are necessary in the manufacture of electronics components and equipment. Publicly traded companies, such as the Company, will be required to disclose certain information concerning the origin of conflict minerals contained in their products. In addition, the Organization for Economic Co-operation and Development (“OECD”) has published Due Diligence Guidance for Responsible Supply Chains of Minerals from Conflict-Affected and High-Risk Areas. The Company intends to utilize this internationally recognized OECD framework to conduct any required due diligence under the Conflict Minerals Rule. The Company is currently in the process of assessing compliance and does not believe there will be any material financial or business impact on the Company as a result.

Note 10. Stockholders’ Equity

Common Stock Repurchase Programs

In October 21, 2008, the Company’s Board of Directors authorized management to repurchase up to 6.0 million shares of the Company’s outstanding common stock. Under this authorization, the timing and actual number of shares subject to repurchase are at the discretion of management and are contingent on a number of factors, such as levels of cash generation from operations, cash requirements for acquisitions and the price of the Company’s common stock. The Company repurchased 2.0 million shares or $63.1 million of common stock under this authorization during the year ended December 31, 2013. The Company did not repurchase any shares under this authorization during the years ended December 31, 2012 and 2011.

The Company repurchased approximately 14,000 shares, or $0.5 million of common stock under a repurchase program to help administratively facilitate the withholding and subsequent remittance of personal income and payroll taxes for individuals receiving RSUs during the year ended December 31, 2013. Similarly, during the years ended December 31, 2012 and December 31, 2011, the Company repurchased approximately 22,000 shares and 25,000 shares, respectively, or $0.9 million and $0.9 million of common stock, respectively, under the same program to help facilitate tax withholding for RSUs.

These shares were retired upon repurchase. The Company’s policy related to repurchases of its common stock is to charge the excess of cost over par value to retained earnings. All repurchases were made in compliance with Rule

10b-18 under the Securities Exchange Act of 1934, as amended.

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Cumulative Other Comprehensive Income, Net

The following table sets forth the changes in accumulated other comprehensive income by component, net of tax, during the years ended December 31, 2013 and 2012 (in thousands):

	Gains and losses on available for sale securities	Gains and losses on derivatives	Total
Beginning balance as of December 31, 2011	$17	$6	$23
Other comprehensive (loss) income before reclassifications	11	164	175
Amounts reclassified from accumulated other comprehensive loss	—	(194)	(194)
Net current period other comprehensive (loss) income	11	(30)	(19)
Beginning balance as of December 31, 2012	$28	$(24)	$4
Other comprehensive (loss) income before reclassifications	(24)	775	751
Amounts reclassified from accumulated other comprehensive loss	—	(686)	(686)
Net current period other comprehensive (loss) income	(24)	89	65
Ending balance as of December 31, 2013	$4	$65	$69

The following tables provide details about significant amounts reclassified out of each component of accumulated other comprehensive income for the years ended December 31, 2013 and 2012 (in thousands):

	Year Ended December 31, 2013		Year Ended December 31, 2012	
Details about Accumulated Other Comprehensive Income Components	Amount Reclassified from AOCI	Affected Line Item in the Statement of Operations	Amount Reclassified from AOCI	Affected Line Item in the Statement of Operations
Gains and losses on cash flow hedge:				
Foreign currency forward contracts	$844	Net revenue	$262	Net revenue
Foreign currency forward contracts	(9)	Cost of revenue	(1)	Cost of revenue
Foreign currency forward contracts	(149)	Operating expenses	(67)	Operating expenses
	686	Total before tax	194	Total before tax
	—	Tax expense (1)	—	Tax expense (1)
	$686	Total, net of tax	$194	Total, net of tax

(1) Under our tax structure all hedging gains and losses from derivative contracts are ultimately borne by a legal entity in a jurisdiction with no income tax.

Note 11. Employee Benefit Plans

2000 Stock Option Plan

In April 2000, the Company adopted the 2000 Stock Option Plan (the “2000 Plan”). The 2000 Plan provides for the granting of stock options to employees and consultants of the Company. Options granted under the 2000 Plan may be either incentive stock options (“ISOs”) or nonqualified stock options (“NSOs”). ISOs may be granted only to Company employees (including officers and directors who are also employees). NSOs may be granted to Company employees, directors and consultants. A total of 7,350,000 shares of Common Stock have been reserved for issuance under the 2000 Plan.

Options under the 2000 Plan may be granted for periods of up to ten years, provided, however, that (i) the exercise price of an ISO and NSO shall not be less than the estimated fair value of the underlying stock on the date of grant and (ii) the exercise price of an ISO and NSO granted to a 10% shareholder shall not be less than 110% of the estimated fair value of the underlying stock on the date of grant. To date, options granted generally vest over four years.

As discussed below, in April 2003, all remaining shares reserved but not issued under the 2000 Plan were transferred to the 2003 Stock Plan.

2003 Stock Plan

In April 2003, the Company adopted the 2003 Stock Plan (the “2003 Plan”). The 2003 Plan provides for the granting of stock options to employees and consultants of the Company. Options granted under the 2003 Plan may be either ISOs or NSOs. ISOs may be granted only to Company employees (including officers and directors who are also employees). NSOs may be granted to Company employees, directors and consultants. The Company has reserved 750,000 shares of Common Stock plus any shares which were reserved but not issued under the 2000 Plan as of the date of the approval of the 2003 Plan. The number of shares which were reserved but not issued under the 2000 Plan that were transferred to the Company’s 2003 Plan were 615,290, which when combined with the shares reserved for the Company’s 2003 Plan total 1,365,290 shares reserved under the Company’s 2003 Plan as of the date of transfer. Any options cancelled under either the 2000 Plan or the 2003 Plan are returned to the pool available for grant. During the second quarter of 2013, the Company's 2003 Stock Plan expired and the remaining unissued 62,791 reserved shares were retired accordingly.

Options under the 2003 Plan may be granted for periods of up to ten years, provided, however, that (i) the exercise price of an ISO and NSO shall not be less than the estimated fair value of the underlying stock on the date of grant and (ii) the exercise price of an ISO and NSO granted to a 10% shareholder shall not be less than 110% of the estimated fair value of the underlying stock on the date of grant. To date, options granted generally vest over four years, with the first tranche vesting at the end of 12 months and the remaining shares underlying the option vesting monthly over the remaining three years. In fiscal 2005, certain options granted under the 2003 Plan immediately vested and were exercisable on the date of grant, and the shares underlying such options were subject to a resale restriction which expires at a rate of 25% per year.

2006 Long Term Incentive Plan

In April 2006, the Company adopted the 2006 Long Term Incentive Plan (the “2006 Plan”), which was approved by the Company’s stockholders at the 2006 Annual Meeting of Stockholders on May 23, 2006. The 2006 Plan provides for the granting of stock options, stock appreciation rights, restricted stock, performance awards and other stock awards, to eligible directors, employees and consultants of the Company. Upon the adoption of the 2006 Plan, the Company reserved 2,500,000 shares of common stock for issuance under the 2006 Plan. In June 2008, the Company adopted amendments to the 2006 Plan which increased the number of shares of the Company’s common stock that may be issued under the 2006 plan by an additional 2,500,000 shares. In July 2010, the Company adopted amendments to the 2006 Plan which increased the number of shares of the Company’s common stock that may be issued under the 2006 plan by an additional 1,500,000 shares. In June 2012, the Company adopted amendments to the 2006 Plan which increased the number of shares of the Company’s common stock that may be issued under the 2006 plan by an additional 3,000,000 shares. In addition, RSUs granted under the 2006 Plan on or after June 6, 2012 are counted against shares authorized under the plan as 1.58 shares of common stock for each share subject to such award. As of December 31, 2013, 1,366,297 shares were reserved for future grants under the 2006 Plan.

Options granted under the 2006 Plan may be either ISOs or NSOs. ISOs may be granted only to Company employees (including officers and directors who are also employees). NSOs may be granted to Company employees, directors and consultants. Options may be granted for periods of up to ten years, provided, however, that (i) the exercise price of an ISO and NSO shall not be less than the estimated fair value of the underlying stock on the date of grant and (ii) the exercise price of an ISO and NSO granted to a 10% shareholder shall not be less than 110% of the estimated fair value of the underlying stock on the date of grant. Options granted under the 2006 Plan generally vest over four years, with the first tranche vesting at the end of 12 months and the remaining shares underlying the option vesting monthly over the remaining three years.

Stock appreciation rights may be granted under the 2006 Plan subject to the terms specified by the plan administrator, provided that the term of any such right may not exceed ten (10) years from the date of grant. The exercise price generally cannot be less than the fair market value of the Company's common stock on the date the stock appreciation right is granted.

Restricted stock awards may be granted under the 2006 Plan subject to the terms specified by the plan administrator. The period over which any restricted award may fully vest is generally no less than three (3) years. Restricted stock awards are non-vested stock awards that may include grants of restricted stock or grants of restricted stock units ("RSUs"). Restricted stock awards are independent of option grants and are generally subject to forfeiture if employment terminates prior to the release of the restrictions. During that period, ownership of the shares cannot be transferred. Restricted stock has the same voting rights as other common stock and is considered to be currently issued and outstanding. RSUs do not have the voting rights of common stock, and the shares underlying the RSUs are not considered issued and outstanding. The Company expenses the cost of the restricted stock awards, which is determined to be the fair market value of the shares at the date of grant, ratably over the period during which the restrictions lapse.

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Performance awards may be in the form of performance shares or performance units. A performance share means an award denominated in shares of Company common stock and a performance unit means an award denominated in units having a dollar value or other currency, as determined by the plan administrator. The plan administrator will determine the number of performance awards that will be granted and will establish the performance goals and other conditions for payment of such performance awards. The period of measuring the achievement of performance goals will be a minimum of twelve (12) months.

Other stock-based awards may be granted under the 2006 Plan subject to the terms specified by the plan administrator. Other stock-based awards may include dividend equivalents, restricted stock awards, or amounts which are equivalent to all or a portion of any federal, state, local, domestic or foreign taxes relating to an award, and may be payable in shares, cash, other securities or any other form of property as the plan administrator may determine.

In the event of a change in control of the Company, all awards under the 2006 Plan vest in full and all outstanding performance shares and performance units will be paid out upon transfer.

Any shares of common stock subject to an award that is forfeited, settled in cash, expires or is otherwise settled without the issuance of shares shall again be available for awards under the 2006 Plan. Additionally, any shares that are tendered by a participant of the 2006 Plan or retained by the Company as full or partial payment to the Company for the purchase of an award or to satisfy tax withholding obligations in connection with an award shall no longer again be made available for issuance under the 2006 Plan.

Employee Stock Purchase Plan

The Company sponsors an Employee Stock Purchase Plan (the “ESPP”), pursuant to which eligible employees may contribute up to 10% of compensation, subject to certain income limits, to purchase shares of the Company’s common stock. Employees may purchase stock semi-annually at a price equal to 85% of the fair market value on the purchase date. Since the price of the shares is determined at the purchase date, the Company recognizes expense based on the 15% discount at purchase. For the years ended December 31, 2013, 2012, and 2011, ESPP compensation expense was $420,000, $371,000 and $354,000, respectively. As of December 31, 2013, 307,500 shares were reserved for future grants under the ESPP.

Option Activity

Stock options activity under the stock option plans during the year ended December 31, 2013 was as follows:

	Outstanding Options			
	Number of Shares	Weighted Average Exercise Price Per Share	Weighted Average Remaining Contractual Term	Aggregate Intrinsic Value
	(In thousands)	(In dollars)	(In years)	(In thousands)
December 31, 2012	4,324	$29.29		
Granted	503	33.45		
Exercised	(352)	21.28		
Cancelled	(249)	34.27		
Expired	(61)	33.78		

December 31, 2013	4,165	$30.11	6.5	$16,376
As of December 31, 2013:				
Vested and expected to vest	4,008	$29.98	6.4	$16,282
Exercisable Options	2,695	$28.29	5.5	$15,245

The aggregate intrinsic values in the table above represent the total pre-tax intrinsic values (the difference between the Company's closing stock price on the last trading day of 2013 and the exercise price, multiplied by the number of shares underlying the in-the-money options) that would have been received by the option holders had all option holders exercised their options on

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December 31, 2013. This amount changes based on the fair market value of the Company's stock. Total intrinsic value of options exercised for the year ended December 31, 2013, 2012, and 2011 was $4.2 million, $8.1 million and $21.8 million, respectively.

The total fair value of options vested during the years ended December 31, 2013, 2012, and 2011 was $13.0 million, $11.1 million and $9.8 million, respectively.

The following table summarizes significant ranges of outstanding and exercisable stock options as of December 31, 2013:

	Options Outstanding			Options Exercisable	
Range of Exercise Prices	Shares Outstanding	Weighted-Average Remaining Contractual Life	Weighted-Average Exercise Price Per Share	Shares Exercisable	Weighted-Average Exercise Price Per Share
	(In thousands)	(In years)	(In dollars)	(In thousands)	(In dollars)
$ 9.26 - $22.68	903	4.73	$18.27	873	$18.18
$23.25 - $31.31	849	5.73	29.58	617	29.23
$31.59 - $33.83	1,203	8.23	33.12	423	33.25
$33.92 - $38.01	959	6.72	35.56	629	35.39
$38.16 - $40.01	251	6.40	39.25	153	39.25
$9.26 - $40.01	4,165	6.50	$30.11	2,695	$28.29

RSU Activity

RSU activity under during the year ended December 31, 2013 was as follows:

	Outstanding RSUs			
	Number of Shares	Weighted Average Grant Date Fair Value Per Share	Weighted Average Remaining Contractual Term	Aggregate Intrinsic Value
	(In thousands)	(In dollars)	(In years)	(In thousands)
December 31, 2012	112	$28.36		
RSUs granted	744	29.20		
RSUs vested	(85)	34.04		
RSUs cancelled	(40)	28.19		
December 31, 2013	731	$29.40	1.61	$24,072

Total intrinsic value of RSUs, or the release date fair value of RSUs, vested during the years ended December 31, 2013, 2012 and 2011 was $2.9 million, $3.7 million and $4.4 million, respectively. The total fair value or RSUs, or the grant date fair value of RSUs, vested during the years ended December 31, 2013, 2012 and 2011 was $2.3 million, $3.0 million and $2.6 million, respectively.

Valuation and Expense Information

The Company measures stock-based compensation at the grant date based on the fair value of the award. Estimated compensation cost relating to restricted stock units (“RSUs”) is based on the closing fair market value of the Company’s common stock on the date of grant. The fair value of Employee Stock Purchase Plan (“ESPP”) is based on the 15% discount at purchase, since the price of the shares is determined at the purchase date. The fair value of each option award is estimated on the date of grant using a Black-Scholes-Merton option valuation model that uses the assumptions noted in the following table. The estimated expected term of options granted is derived from historical data on employee exercise and post-vesting employment termination behavior. The risk free interest rate is based on the implied yield currently available on U.S. Treasury securities with a remaining

term commensurate with the estimated expected term. Expected volatility is based on historical volatility over the most recent period commensurate with the estimated expected term.
The following table sets forth the weighted-average assumptions used to fair value option grants during the years ended December 31, 2013, 2012 and 2011 based on its historical experience:

	Year Ended December 31,					
	2013		2012		2011	
Expected life (in years)	4.4		4.4		4.4	
Risk-free interest rate	0.72	%	0.64	%	1.63	%
Expected volatility	48.05	%	52.09	%	50.31	%
Dividend yield	—		—		—	

The weighted average estimated fair value of options granted during the years ended December 31, 2013, 2012 and 2011 was $13.29, $13.99 and $14.29, respectively.

The following table sets forth the total stock-based compensation expense resulting from stock options, restricted stock awards, and the Employee Stock Purchase Plan included in the Company's Consolidated Statements of Operations (in thousands):

	Year Ended December 31,		
	2013	2012	2011
Cost of revenue	$1,577	$1,347	$999
Research and development	3,943	2,787	2,476
Sales and marketing	5,379	4,751	5,136
General and administrative	6,563	5,487	5,151
Total	$17,462	$14,372	$13,762

The Company recognizes these compensation costs net of the estimated forfeitures on a straight-line basis over the requisite service period of the award, which is generally the option vesting term of four years.

Total stock-based compensation cost capitalized in inventory was less than $0.5 million in each of the years ended December 31, 2013, 2012 and 2011.

As of December 31, 2013, $16.7 million of total unrecognized compensation cost related to stock options is expected to be recognized over a weighted-average period of 2.3 years. As of December 31, 2013, $14.0 million of total unrecognized compensation cost related to non-vested RSUs is expected to be recognized over a weighted-average period of 3.0 years.

401(k) Plan

In April 2000, the Company adopted the NETGEAR 401(k) Plan to which employees may contribute up to 100% of salary subject to the legal maximum. In the first quarter of 2012, the Company began matching 50% of contributions for employees that remain active with the company through the end of the fiscal year, up to a maximum of $6,000 in employee contributions. During the years ended December 31, 2013 and 2012 the Company recognized $1.0 million and $0.7 million, respectively, in expenses related to the 401(k) match. No match was offered in 2011 and thus no expenses were recorded related to matching employee contributions during that year.

Note 12. Segment Information, Operations by Geographic Area and Customer Concentration

Operating segments are components of an enterprise about which separate financial information is available and is regularly evaluated by management, namely the Chief Operating Decision Maker ("CODM") of an organization, in order to determine operating and resource allocation decisions. By this definition, the Company operates in three specific business units: retail, commercial, and service provider. The retail business unit consists of high performance, dependable and easy-to-use home

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networking, home video monitoring, storage and digital media products. The commercial business unit consists of business networking, storage and security solutions that bring enterprise class functionality down to the small and medium size business at an affordable price. The service provider business unit consists of made-to-order and retail proven, whole home networking hardware and software solutions as well as 4G LTE hotspots sold to service providers for sale to their subscribers. Each business unit is managed by a Senior Vice President/General Manager. The Company believes this structure enables it to better focus its efforts on the Company's core customer segments and allows it to be more nimble and opportunistic as a company overall.

The results of the reportable segments are derived directly from the Company's management reporting system. The results are based on the Company's method of internal reporting and are not necessarily in conformity with accounting principles generally accepted in the United States. Management measures the performance of each segment based on several metrics, including contribution income. Segment contribution income includes all product line segment revenues less the related cost of sales, research and development and sales and marketing costs. Contribution income is used, in part, to evaluate the performance of, and allocate resources to, each of the segments. Certain operating expenses are not allocated to segments because they are separately managed at the corporate level. These unallocated indirect costs include corporate costs, such as corporate research and development, general and administrative costs, stock-based compensation expenses, amortization of intangibles, acquisition-related integration costs, restructuring costs, litigation reserves and interest and other income (expense), net. The Company does not evaluate operating segments using discrete asset information.

Financial information for each reportable segment and a reconciliation of segment contribution income to income before income taxes is as follows (in thousands, except percentage data):

	Year Ended December 31,					
	2013		2012		2011	
Net revenues:						
Retail	$509,924		$504,797		$481,795	
Commercial	311,261		307,945		331,439	
Service provider	548,448		459,179		367,784	
Total net revenues	$1,369,633		$1,271,921		$1,181,018	
Contribution income:						
Retail	$73,418		$86,808		$81,589	
Retail contribution margin	14.4	%	17.2	%	16.9	%
Commercial	66,506		67,826		74,746	
Commercial contribution margin	21.4	%	22.0	%	22.6	%
Service Provider	51,620		40,794		32,797	
Service Provider contribution margin	9.4	%	8.9	%	8.9	%
Total segment contribution income	191,544		195,428		189,132	
Corporate and unallocated costs	(51,629	)	(47,766	)	(43,301	)
Amortization of intangible assets (1)	(15,217	)	(4,763	)	(4,658	)
Stock-based compensation expense	(17,462	)	(14,372	)	(13,762	)
Restructuring and other charges	(5,335	)	(1,190	)	(2,094	)
Acquisition-related expense (2)	(940	)	(833	)	(40	)
Impact to cost of sales from acquisition accounting adjustments to inventory	(568	)	—		(609	)
Litigation reserves, net	(5,354	)	(390	)	201	
Impairment of intangibles	(2,000	)	—		—	

Interest income	400	498	477
Other income (expense), net	(457)	2,670	(1,136)
Income before income taxes	$92,982	$129,282	$124,210

(1) Amount excludes amortization expense related to patents within purchased intangible assets in costs of revenues.

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NETGEAR, INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)

(2) These acquisition-related charges were expensed in the period incurred and reported in the Company's consolidated statements of operations within cost of revenues and operating expense.

The Company conducts business across three geographic regions: Americas, Europe, Middle-East and Africa (“EMEA”) and Asia Pacific ("APAC'). Net revenue by geography comprises gross revenue less such items as end-user customer rebates and other sales incentives deemed to be a reduction of net revenue per the authoritative guidance for revenue recognition, sales returns and price protection. For reporting purposes revenue is attributed to each geographic region based on the location of the customer.

The following table shows net revenue by geography for the periods indicated (in thousands):

	Year Ended December 31,		
	2013	2012	2011
United States	$769,357	$660,998	$570,143
Americas (excluding U.S.)	19,961	18,421	16,913
United Kingdom	142,729	184,404	165,522
EMEA (excluding U.K.)	269,959	273,320	312,191
APAC	167,627	134,778	116,249
Total net revenue	$1,369,633	$1,271,921	$1,181,018

No single customer accounted for greater than 10% of net revenues in the years ended December 31, 2013 and 2012. For the year ended December 31, 2011, retailer, Best Buy Inc. and distributor, Ingram Micro, Inc. represented approximately 11% and 10% of net revenues respectively.
Property and equipment by geographic location are as follows (in thousands):

	December 31, 2013	December 31, 2012
United States	$10,273	$9,898
Americas (excluding U.S.)	2,160	36
EMEA	914	1,173
China	11,905	6,763
APAC (excluding China)	1,942	1,155
	$27,194	$19,025

Note 13. Fair Value Measurements

The Company determines the fair values of its financial instruments based on a fair value hierarchy, which requires an entity to maximize the use of observable inputs and minimize the use of unobservable inputs when measuring fair value. The classification of a financial asset or liability within the hierarchy is based upon the lowest level input that is significant to the fair value measurement. The fair value hierarchy prioritizes the inputs into three levels that may be used to measure fair value:

Level 1: Unadjusted quoted prices in active markets that are accessible at the measurement date for identical, unrestricted assets or liabilities;

Level 2: Quoted prices in markets that are not active, or inputs which are observable, either directly or indirectly, for substantially the full term of the asset or liability;

Level 3: Prices or valuation techniques that require inputs that are both significant to the fair value measurement and unobservable (i.e., supported by little or no market activity).

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NETGEAR, INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)

The following tables summarize assets and liabilities measured at fair value on a recurring basis as of December 31, 2013 and 2012 (in thousands):

	As of December 31, 2013			
	Total	Quoted market prices in active markets (Level 1)	Significant other observable inputs (Level 2)	Significant unobservable inputs (Level 3)
Cash equivalents-money-market funds	$31,295	$ 31,295	$—	$—
Available-for-sale securities-Treasuries (1)	104,601	104,601	—	—
Available-for-sale securities-Certificates of Deposit (1)	159	159	—	—
Trading securities - Mutual Funds (1)	385	385	—	—
Foreign currency forward contracts (2)	905	—	905	—
Total assets measured at fair value	$137,345	$ 136,440	$905	$—

(1) Included in short-term investments on the Company's consolidated balance sheet.
(2) Included in prepaid expenses and other current assets on the Company's consolidated balance sheet.

	As of December 31, 2013			
	Total	Quoted market prices in active markets (Level 1)	Significant other observable inputs (Level 2)	Significant unobservable inputs (Level 3)
Foreign currency forward contracts (3)	$(381)	$—	$(381)	$—
Total liabilities measured at fair value	$(381)	$—	$(381)	$—

(3) Included in other accrued liabilities on the Company's consolidated balance sheet.

	As of December 31, 2012			
	Total	Quoted market prices in active markets (Level 1)	Significant other observable inputs (Level 2)	Significant unobservable inputs (Level 3)
Cash equivalents-money-market funds	$3,061	$ 3,061	$—	$—
Available-for-sale securities-Treasuries (1)	225,062	225,062	—	—
Available-for-sale securities-Certificates of Deposit (1)	2,783	2,783	—	—
Foreign currency forward contracts (2)	1,144	—	1,144	—
Total assets measured at fair value	$232,050	$ 230,906	$1,144	$—

(1) Included in short-term investments on the Company's consolidated balance sheet.
(2) Included in prepaid expenses and other current assets on the Company's consolidated balance sheet.

	As of December 31, 2012			
	Total	Quoted market	Significant	Significant

		prices in active markets (Level 1)	other observable inputs (Level 2)	unobservable inputs (Level 3)
Foreign currency forward contracts (3)	$(1,619)	$—	$(1,619)	$—
Total liabilities measured at fair value	$(1,619)	$—	$(1,619)	$—

(3) Included in other accrued liabilities on the Company's consolidated balance sheet.

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NETGEAR, INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)

The Company's investments in cash equivalents and available-for-sale securities are classified within Level 1 of the fair value hierarchy because they are valued based on quoted market prices in active markets. The Company enters into foreign currency forward contracts with only those counterparties that have long-term credit ratings of A+/A2 or higher. The Company's foreign currency forward contracts are classified within Level 2 of the fair value hierarchy as they are valued using pricing models that take into account the contract terms as well as currency rates and counterparty credit rates. The Company verifies the reasonableness of these pricing models using observable market data for related inputs into such models. Additionally, the Company includes an adjustment for non-performance risk in the recognized measure of fair value of derivative instruments. At December 31, 2013 and December 31, 2012, the adjustment for non-performance risk did not have a material impact on the fair value of the Company's foreign currency forward contracts. The carrying value of non-financial assets and liabilities measured at fair value in the financial statements on a recurring basis, including accounts receivable and accounts payable, approximate fair value due to their short maturities.

QUARTERLY FINANCIAL DATA
(In thousands, except per share amounts)
(Unaudited)

The following table presents unaudited quarterly financial information for each of the Company’s last eight quarters. This information has been derived from the Company’s unaudited financial statements and has been prepared on the same basis as the audited Consolidated Financial Statements appearing elsewhere in this Annual Report on Form 10-K. In the opinion of management, all necessary adjustments, consisting only of normal recurring adjustments, have been included to state fairly the quarterly results.

	December 31, 2013	September 29, 2013	June 30, 2013	March 31, 2013
Net revenue	$356,620	$361,895	$357,719	$293,399
Gross profit	$100,789	$101,659	$103,430	$87,737
Provision for income taxes	$11,712	$10,364	$7,144	$8,545
Net income	$11,432	$14,457	$13,985	$15,343
Net income per share—basic	$0.30	$0.37	$0.36	$0.40
Net income per share—diluted	$0.30	$0.37	$0.36	$0.39

	December 31, 2012	September 30, 2012	July 1, 2012	April 1, 2012
Net revenue	$310,436	$315,210	$320,655	$325,620
Gross profit	$91,378	$97,688	$94,638	$99,849
Provision for income taxes	$12,325	$9,920	$9,933	$10,565
Net income	$16,079	$23,791	$21,522	$25,147
Net income per share—basic	$0.42	$0.62	$0.57	$0.67
Net income per share—diluted	$0.41	$0.61	$0.56	$0.65

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Item 9. Changes in and Disagreements With Accountants on Accounting and Financial Disclosure

None.

Item 9A. Controls and Procedures

Management's Report on Internal Control Over Financial Reporting

Our management is responsible for establishing and maintaining adequate internal control over financial reporting (as defined in Rule 13a-15(f) under the Exchange Act). Because of its inherent limitations, internal control over financial reporting may not prevent or detect misstatements. Also, projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

Our management, including our Chief Executive Officer and Chief Financial Officer, conducted an evaluation of the effectiveness of our internal control over financial reporting as of December 31, 2013. In making this assessment, our management used the criteria established in Internal Control—Integrated Framework (1992), issued by The Committee of Sponsoring Organizations of the Treadway Commission (COSO). Based on management's assessment using those criteria, our management concluded that our internal control over financial reporting was effective as of December 31, 2013. The effectiveness of our internal control over financial reporting as of December 31, 2013 has been audited by PricewaterhouseCoopers LLP, an independent registered public accounting firm, as stated in their report which is included in this Annual Report on Form 10-K.

Changes in Internal Control Over Financial Reporting

There was no change in our internal control over financial reporting that occurred during the fourth quarter of fiscal year 2013 that has materially affected, or is reasonably likely to materially affect, our internal control over financial reporting.

Evaluation of Disclosure Controls and Procedures

Based on an evaluation under the supervision and with the participation of our management (including our Chief Executive Officer and Chief Financial Officer), our Chief Executive Officer and Chief Financial Officer have concluded that our disclosure controls and procedures as defined in Rules 13a-15(e) and 15d-15(e) under the Exchange Act were effective as of the end of the period covered by this Annual Report on Form 10-K to ensure that information required to be disclosed by us in reports that we file or submit under the Exchange Act is (i) recorded, processed, summarized and reported within the time periods specified in the SEC's rules and forms and (ii) accumulated and communicated to our management, including our Chief Executive Officer and Chief Financial Officer, as appropriate to allow timely decisions regarding required disclosure.

Item 9B. Other Information

None.

PART III

Certain information required by Part III is incorporated herein by reference from our proxy statement related to our 2014 Annual Meeting of Stockholders, which we intend to file no later than 120 days after the end of the fiscal year covered by this Form 10-K.

Item 10. Directors, Executive Officers and Corporate Governance

The information required by this Item concerning our directors, executive officers, standing committees and procedures by which stockholders may recommend nominees to our Board of Directors, is incorporated by reference to the sections of our Proxy Statement under the headings "Information Concerning the Nominees and Incumbent Nominees," "Board and Committee Meetings," "Audit Committee" and "Section 16(a) Beneficial Ownership Reporting Compliance," and to the information contained in the section captioned "Executive Officers of the Registrant" included under Part I of this Annual Report on Form 10-K.

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We have adopted a Code of Ethics that applies to our Chief Executive Officer and senior financial officers, as required by the SEC. The current version of our Code of Ethics can be found on our Internet site at http://www.netgear.com. Additional information required by this Item regarding our Code of Ethics is incorporated by reference to the information contained in the section captioned "Corporate Governance Policies and Practices" in our Proxy Statement.

We intend to satisfy the disclosure requirement under Item 5.05 of Form 8-K regarding an amendment to, or waiver from, a provision of our Code of Ethics by posting such information on our website at http://www.netgear.com within four business days following the date of such amendment or waiver.

Item 11. Executive Compensation

The information required by this Item is incorporated by reference to the sections of our Proxy Statement under the headings "Compensation Discussion and Analysis," "Executive Compensation," "Director Compensation," "Fiscal Year 2013 Director Compensation," "Compensation Committee Interlocks and Insider Participation," and "Report of the Compensation Committee of the Board of Directors."

Item 12. Security Ownership of Certain Beneficial Owners and Management and Related Stockholder Matters

The additional information required by this Item is incorporated by reference to the information contained in the section captioned "Equity Compensation Plan Information" in our Proxy Statement.

The additional information required by this Item is incorporated by reference to the information contained in the section captioned "Security Ownership of Certain Beneficial Owners and Management" in our Proxy Statement.

Item 13. Certain Relationships and Related Transactions, and Director Independence

The information required by this Item is incorporated by reference to the information contained in the section captioned "Election of Directors" and "Related Party Transactions" in our Proxy Statement.

Item 14. Principal Accounting Fees and Services

The information required by this Item related to audit fees and services is incorporated by reference to the information contained in the section captioned "Ratification of Appointment of Independent Registered Public Accounting Firm" appearing in our Proxy Statement.

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PART IV

Item 15. Exhibits, Financial Statement Schedule

(a) The following documents are filed as part of this report:

(1) Financial Statements.

(2) Financial Statement Schedule.

The following financial statement schedule of NETGEAR, Inc. for the fiscal years ended December 31, 2013, 2012 and 2011 is filed as part of this Form 10-K and should be read in conjunction with the Consolidated Financial Statements of NETGEAR, Inc.

Schedule II—Valuation and Qualifying Accounts
(In thousands)

	Balance at Beginning of Year	Additions	Deductions	Balance at End of Year
Allowance for doubtful accounts:				
Year ended December 31, 2013	$1,256	$277	$(278)	$1,255
Year ended December 31, 2012	1,335	43	(122)	1,256
Year ended December 31, 2011	1,481	(21)	(125)	1,335
Allowance for sales returns and product warranty:				
Year ended December 31, 2013	63,690	104,810	(102,279)	66,221
Year ended December 31, 2012	58,206	100,806	(95,322)	63,690
Year ended December 31, 2011	50,786	86,310	(78,890)	58,206
Allowance for price protection:				
Year ended December 31, 2013	1,783	8,352	(5,862)	4,273
Year ended December 31, 2012	3,930	9,925	(12,072)	1,783
Year ended December 31, 2011	3,147	15,688	(14,905)	3,930

(3) Exhibits.

The exhibits listed in the accompanying Index to Exhibits are filed or incorporated by reference as part of this report.

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SIGNATURES

Pursuant to the requirements of Section 13 or 15(d) of the Securities Exchange Act of 1934, the Registrant has duly caused this Annual Report to be signed on its behalf by the undersigned, thereunto duly authorized, in the City of San Jose, State of California, on the 25th day of February 2014.

NETGEAR, INC.
By: /s/ PATRICK C.S. LO
Patrick C.S. Lo
Chairman of the Board and Chief Executive Officer

POWER OF ATTORNEY

KNOW ALL PERSONS BY THESE PRESENTS, that each person whose signature appears below constitutes and appoints Patrick C.S. Lo and Christine M. Gorjanc, and each of them, his attorneys-in-fact, each with the power of substitution, for him in any and all capacities, to sign any and all amendments to this Report on Form 10-K and to file the same, with exhibits thereto and other documents in connection therewith, with the Securities and Exchange Commission, hereby ratifying and confirming all that each of said attorneys-in-fact, or his substitute or substitutes, may do or cause to be done by virtue hereof.

Pursuant to the requirements of the Securities Exchange Act of 1934, this report has been signed below by the following persons on behalf of the Registrant and in the capacities and on the dates indicated:

Signature	Title	Date
/S/ PATRICK C.S. LO Patrick C.S. Lo	Chairman of the Board and Chief Executive Officer (Principal Executive Officer)	February 25, 2014
/S/ CHRISTINE M. GORJANC Christine M. Gorjanc	Chief Financial Officer (Principal Financial and Accounting Officer)	February 25, 2014
/S/ JOCELYN CARTER-MILLER Jocelyn Carter-Miller	Director	February 25, 2014
/S/ RALPH E. FAISON Ralph E. Faison	Director	February 25, 2014
/S/ A. TIMOTHY GODWIN A. Timothy Godwin	Director	February 25, 2014
/S/ JEF GRAHAM Jef Graham	Director	February 25, 2014
/S/ LINWOOD A. LACY, JR. Linwood A. Lacy, Jr.	Director	February 25, 2014

/S/ GREGORY J. ROSSMANN Gregory J. Rossmann	Director	February 25, 2014
/S/ BARBARA V. SCHERER Barbara V. Scherer	Director	February 25, 2014
/S/ JULIE A. SHIMER Julie A. Shimer	Director	February 25, 2014

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INDEX TO EXHIBITS

Exhibit Number	Description
2.1**	Asset Purchase Agreement, dated as of September 22, 2008, by and among CP Secure International Holding Limited, the stockholders thereof and the registrant(1)
3.3	Amended and Restated Certificate of Incorporation of the registrant(2)
3.5	Amended and Restated Bylaws of the registrant(2)
4.1	Form of registrant's common stock certificate(2)
10.1	Form of Indemnification Agreement for directors and officers(2)
10.2#	2000 Stock Option Plan and forms of agreements thereunder(2)
10.3#	2003 Stock Plan and forms of agreements thereunder, as amended (3)
10.4#	2003 Employee Stock Purchase Plan, as amended (4)
10.5#	Offer Letter, dated December 3, 1999, between the registrant and Patrick C.S. Lo(2)
10.8#	Offer Letter, dated December 9, 1999, between the registrant and Mark G. Merrill(2)
10.9#	Employment Agreement, dated November 4, 2002, between the registrant and Michael F. Falcon(2)
10.10#	Employment Agreement, dated January 6, 2003, between the registrant and Charles T. Olson(2)
10.12#	Employment Agreement, dated November 16, 2005, between the registrant and Christine M. Gorjanc(5)
10.14*	Distributor Agreement, dated March 1, 1997, between the registrant and Tech Data Product Management, Inc.(2)
10.15*	Distributor Agreement, dated March 1, 1996, between the registrant and Ingram Micro Inc., as amended by Amendment dated October 1, 1996 and Amendment No. 2 dated July 15, 1998(2)
10.24*	Warehousing Agreement, dated July 5, 2001, between the registrant and APL, Logistics Americas, Ltd.(2)
10.25*	Distribution Operation Agreement, dated April 27, 2001, between the registrant and DSV Solutions B.V. (formerly Furness Logistics BV)(2)
10.26*	Distribution Operation Agreement, dated December 1, 2001, between the registrant and Kerry Logistics (Hong Kong) Limited(2)
10.33#	2006 Long Term Incentive Plan and forms of agreements thereunder(6)
10.34	Agreement and Plan of Merger, dated as of July 26, 2006, by and among the registrant, SKJM Holdings Corporation, SkipJam Corp., Michael Spilo, Jonathan Daub, Francis Refol, Dennis Aldover and Zhicheng Qiu(7)
10.35	Asset Purchase Agreement, dated as of January 28, 2013, by and among the registrant, NETGEAR Holdings Limited, NETGEAR International Limited, NETGEAR Canada Limited, NETGEAR Australia PTY, LTD, Sierra Wireless, Inc., Sierra Wireless, Inc., Sierra Wireless America, Inc. and Sierra Wireless (Australia) PTY LTD(8)
10.41**	Agreement and Plan of Merger, dated as of May 2, 2007, by and among the registrant, NAS Holdings Corporation, Infrant Technologies, Inc., certain Infrant shareholders thereof, and Paul Tien as the Holders Representative (9)
10.44	Office Lease, dated as of September 25, 2007, by and between the registrant and BRE/Plumeria, LLC (10)
10.45	First Amendment to Office Lease, dated as of April 23, 2008, by and between the registrant and BRE/Plumeria, LLC (11)
10.46#	Amended and Restated 2006 Long-Term Incentive Plan (12)
10.47#	NETGEAR, Inc. Executive Bonus Plan (12)
10.49#	Amendment to Employment Agreement, dated December 29, 2008, between the registrant and Michael F. Falcon (13)
10.50#	Amendment to Employment Agreement, dated December 31, 2008, between the registrant and Christine Gorjanc (13)

10.51#	Amendment to Offer Letter, dated December 23, 2008, between the registrant and Patrick Lo (13)
10.52#	Amendment to Offer Letter, dated December 28, 2008, between the registrant and Mark Merrill (13)
10.53#	Amendment to Employment Agreement, dated December 24, 2008, between the registrant and Chuck Olson (13)
10.54#	Amendment to Employment Agreement, dated December 30, 2008, between the registrant and Michael Werdann (13)
10.55#	Amendment #2 to Employment Agreement, dated September 21, 2009, between the registrant and Christine Gorjanc (14)
10.56#	Change of Control and Severance Agreement dated March 31, 2011 by and between NETGEAR, Inc. and David Soares (15)
10.57#	Change of Control and Severance Agreement dated January 25, 2012, by and between NETGEAR, Inc. and Michael Clegg (16)
10.58#	NETGEAR, Inc. Deferred Compensation Plan (17)
10.59#	NETGEAR, Inc. Executive Bonus Plan, as amended and restated April 1, 2013 (18)

10.60#	Employment Agreement, dated July 8, 2013, between NETGEAR, Inc. and John McHugh (19)
21.1	List of subsidiaries and affiliates
23.1	Consent of PricewaterhouseCoopers LLP, Independent Registered Public Accounting Firm
24.1	Power of Attorney (included on signature page)
31.1	Certification of Chief Executive Officer pursuant to Securities Exchange Act Rules 13a-14(a) / 15d-14(a), as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002
31.2	Certification of Chief Financial Officer pursuant to Securities Exchange Act Rules 13a-14(a) / 15d-14(a), as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002
32.1	Certification of Chief Executive Officer pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002
32.2	Certification of Chief Financial Officer pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002
101.INS***	XBRL Instance Document
101.SCH***	XBRL Taxonomy Extension Schema Document
101.CAL***	XBRL Taxonomy Extension Calculation Linkbase Document
101.DEF***	XBRL Taxonomy Extension Definition Linkbase Document
101.LAB***	XBRL Taxonomy Extension Label Linkbase Document
101.PRE***	XBRL Taxonomy Extension Presentation Linkbase Document

#	Indicates management contract or compensatory plan or arrangement.
*	Confidential treatment has been granted as to certain portions of this Exhibit.
**	Registrant hereby agrees to furnish a copy of the omitted schedules and exhibits to the Securities and Exchange Commission upon its request.
***	XBRL (Extensible Business Reporting Language) information is furnished and not filed or a part of a registration statement or prospectus for purpose of Section 11 or 12 of the Securities Act of 1933, as amended, is deemed not filed for purposes of Section 18 of the Securities Exchange Act of 1934, as amended, and otherwise is not subject to liability under these sections.
(1)	Incorporated by reference to the exhibit bearing the same number filed with the Registrant's Current Report on Form 8-K filed on September 23, 2008 with the Securities and Exchange Commission.
(2)	Incorporated by reference to an exhibit filed with the Registrant's Registration Statement on Form S-1 (Registration Statement 333-104419), which the Securities and Exchange Commission declared effective on July 30, 2003.
(3)	Incorporated by reference to Exhibit 10.3 of the Registrant's Annual Report on Form 10-K filed on February 26, 2013 with the Securities and Exchange Commission.
(4)	Incorporated by reference to Exhibit 10.4 of the Registrant's Annual Report on Form 10-K filed on February 26, 2013 with the Securities and Exchange Commission.
(5)	Incorporated by reference to Exhibit 10.32 of the Registrant's Current Report on Form 8-K filed on November 22, 2005 with the Securities and Exchange Commission.
(6)	Incorporated by reference to the copy included in the Registrant's Proxy Statement for the 2006 Annual Meeting of Stockholders filed on April 21, 2006 with the Securities and Exchange Commission.
(7)	Incorporated by reference to Exhibit 2.1 of the Registrant's Current Report on Form 8-K filed on July 27, 2006 with the Securities and Exchange Commission.
(8)	Incorporated by reference to Exhibit 10.35 of the Registrant's Annual Report on Form 10-K filed on February 26, 2013 with the Securities and Exchange Commission.
(9)	Incorporated by reference to Exhibit 2.1 of the Registrant's Current Report on Form 8-K filed on May 3, 2007 with the Securities and Exchange Commission.
(10)	Incorporated by reference to Exhibit 10.1 of the Registrant's Current Report on Form 8-K filed on September 27, 2007 with the Securities and Exchange Commission.
(11)	Incorporated by reference to Exhibit 10.1 of the Registrant's Quarterly Report on Form 10-Q filed on May 9, 2008 with the Securities and Exchange Commission.
(12)	Incorporated by reference to the copy included in the Registrant's Proxy Statement for the 2008 Annual Meeting of Stockholders filed on April 28, 2008 with the Securities and Exchange Commission.
(13)	Incorporated by reference to the copy included in the Registrant's Annual Report on Form 10-K filed on March 4, 2009 with the Securities and Exchange Commission.
(14)	Incorporated by reference to Exhibit 10.1 of the Registrant's Current Report on Form 8-K filed on September 21, 2009 with the Securities and Exchange Commission.
(15)	Incorporated by reference to Exhibit 10.1 of the Registrant's Current Report on Form 8-K filed on April 4, 2011 with the Securities and Exchange Commission.
(16)	Incorporated by Reference to Exhibit 10.11 of the Registrant's Quarterly Report on Form 10-Q filed on May 7, 2013 with the Securities and Exchange Commission.
(17)	Incorporated by reference to Exhibit 10.1 of the Registrant's Current Report on Form 8-K filed on April 5, 2013 with the Securities and Exchange Commission.
(18)	Incorporated by reference to Appendix A of the Registrant's Definitive Proxy Statement filed on April 16, 2013 with the Securities and Exchange Commission.
(19)	Incorporated by reference to Exhibit 10.1 of the Registrant's Current Report on Form 8-K filed on July 11, 2013 with the Securities and Exchange Commission.

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